# Breach of Trust

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Edited by

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# *Preface*

The modernization which the law of trusts has long needed is now proceeding through a number of different modalities, most recently through the Trustee Act 2000. In the context of breach, modernization does not imply profound substantive reform so much as escape from the obscurity of the language and patterns of thought of an earlier age. That necessary metamorphosis has so far been largely neglected.

A

As it stands the law of breach of trust still has a very nineteenth century character. It has not caught up with two changes which have profoundly altered the way in which common lawyers think. These changes are not unrelated. One is that it is no longer obligatory to take pride in the old duality of law and equity. On the contrary one of the greatest intellectual challenges is now acknowledged to be the struggle to rid the law of that duality. There is one law to which two jurisdictional streams have contributed. Their different contributions will still be recognizable but contradictions and duplications will be eliminated. There is no longer any need, for instance, to insist on separating common law torts and equitable wrongs or to double up the vocabulary of money awards for wrongs to preserve the distinction between damages and equitable compensation. The law of trusts must not be regarded as a hermetically sealed package, and breach of trust has to take its proper place in our list of civil wrongs.

The other, larger change is that the rise of university law schools, and hence of jurists who function outside the turbulent process of litigation and adjudication, has begun to liberate legal rationality from the absolute monopoly of the cases. Academic jurists are entitled and bound to coin new names when old ones refuse to assemble like with like. Much as the law of restitution is being rid of "money had and received," "quasi-contract" and "constructive contracts," so the law of breach of trust can be restated for the twenty-first century free from obscure and sometimes fictionalizing linguistic formulae inherited from the past, and it can be ordered in accordance with concepts and classifications now familiar in other areas of the law.

Nothing in the previous paragraph suggests that in the interpretative development of the law academics now sit in the driving seat. They do not. In a common law system judges are and will remain dominant. In this very field the law reports already show the modernizing creativity of great judges such as Lord Nicholls and Lord Millett. But between the courts and the universities there is

now something in the nature of a joint venture. Its effects are beneficial, and in recent decades it has been picking up steam.

B

Modernization cannot be achieved overnight, nor by one multi-authored book. Our hope nonetheless is that this volume will accelerate the process. It has itself been gestating for some time. The project was initiated some three years ago and came to fruition in a symposium held at All Souls in April 2001. That symposium was chaired by Mr Justice Patten and attended by Lord Millett and Lord Justice Mummery. It heard and discussed a dozen papers, which, reconsidered and rewritten, have become the chapters in this volume.

It is obviously difficult, indeed in some senses quite impossible, to sever the law of breach of trust from the law which lays down the duties of trustees. In a book on breach the emphasis has to be on the consequences of breach rather than on the content of the duties. By consequences is meant the different kinds of liability, together with defences and excuses and the law relating to the involvement of third parties. There is no bright line between duties and breach. It is a matter of emphasis.

It is no part of this introduction to duplicate the overview by Professor Hayton which now appears as the final chapter. However, in order to explain the structure of the book, we need to say what we, as editors, see as the principal focuses of the process of modernization in this area. These can for convenience be reduced to five: (1) achieving a better classification of breaches of trust; (2) streamlining the language of the remedial rights arising from breaches; (3) explaining the behaviour of proprietary rights when assets are misapplied; (4) overhauling the law and language relating to the liability of third parties who deal with trustees in breach; and (5) revising the different mechanisms used to curb or reduce the trustee's liability. These five areas are not perfectly separable one from another. Several of the chapters which follow address more than one. But, as will be said more fully immediately below, their sequence is nonetheless determined by this list of concerns.

C

The paragraphs which follow very briefly attempt to sketch in the main lines of the problems of each of the five areas which have just been identified.

## 1 Breaches of Trust

Even here where the emphasis is on the consequences of breach, the first necessity is a clear picture of the different kinds of breach. The expression "breach of

trust" sounds sharp enough. In fact it is irritatingly nebulous. It needs to be stabilized and clarified by means of a sound classification of the wrongs which it comprehends. Here the beginning of wisdom is that breaches of trust are of two distinct kinds. It is helpful to borrow language more familiar in public law. There are breaches which consist in ultra vires acts and there are breaches which consist in doing badly acts which, done properly, would be intra vires.

There is a great difference between the two categories, for in the former fault is irrelevant. The wrong consists in the doing of something that a trustee may not do. The latter category absolutely depends on proof of fault. Without the element of fault the conduct could not be conceived to be a breach of duty. Hence in the former category liability is strict, in the latter fault-based.

In the category of ultra vires acts fall misapplications of the trust fund. A distribution must not be made to a person who is not a beneficiary. Again, although the latest statutory reforms in this regard greatly reduce the risk of this happening, the fund must not be put into unauthorized investments. Misdispositions of that kind suggest fraud but they can happen innocently, as where the trustee makes an unavoidable mistake. In this second category also falls the breach which is commonly called, rather imprecisely, "conflict of interest". A trustee must not pursue any interest where there is a real possibility that its pursuit might tempt him to sacrifice the interest of his beneficiary. It is repeated time and again that such a breach is entirely independent of fault. Save so far as the duty may be expressly or impliedly released, a trustee must steer clear of conflicts of interest.

In the second main category falls mismanagement of the trust portfolio. It might be objected that this too is ultra vires. Bad management is also something that the trustee must not do. But the difference is that the wrong now consists of doing badly something that he is entitled to do, whereas in the other cases he does something that he must not do at all. In this category the law's main task is to specify the standard to which the trustee's management must conform and with it the kind of fault which will make him liable. Through a welter of divergent terminology it has slowly become clear that the standard is the common standard of a person in his position and his liability is for negligence. The single wrong which we call negligence has to adapt itself to different contexts. Lawyers have to know the details of its specialized adaptations, but they will understand better what they are doing if they know from the outset what larger category they are working in. The law cannot yet be said to have fully secured that straightforward starting point. It has not unequivocally committed itself to the proposition that negligence is as much negligence in an equitable as in a common law matrix. The restatement of the trustee's duty of care in the new Act should not be allowed to obstruct that assimilation. Properly understood, it is a consummation.

A firm classification of breaches of trust must be accompanied by a differentiation of other events which can render a trustee liable. Breach of trust is correctly called a wrong because it derives its actionability from its character as a breach of duty. The trustee is liable because he has broken a primary duty, as for

instance to stay within his powers or to conform to a given standard of management. But a trustee may incur liabilities which are entirely independent of wrongdoing. He may for instance incur a liability for the non-wrong of unjust enrichment. In relation to the first category of breach of trust there arises a complication of this kind which is of great importance.

Every wrong is a breach of a duty. That superstructural duty often remains more or less out of sight. Even a *quia timet* injunction tends to be seen as preventing the wrong rather than enforcing the primary superstructural right. Thus an injunction to prevent pursuit of a conflicting interest might be viewed in that light. But in relation to misdispositions of the trust property, including unauthorized investments, the law has traditionally fired precisely on the primary level. Just as a person can owe, and be compelled to pay, a certain sum of money because he promised to pay it, not because he broke his promise, so a trustee's liability for the trust property does not have to wait for the wrong of breach of trust. His liability can be ascribed directly to the wrong but it need not be.

The trustee's liability for the trust fund can be said to arise simply from his having received it on trust. His assumption of the trust makes him constantly accountable for the property so received. He has to honour the account, That is, he must produce that which the account shows him to have. When the account is taken he cannot take credit for misdispositions. So the account will show the fund as standing at a level higher than the trustee actually holds. Suppose that he received 1000. He slipped 500 to a friend, lost 200 in a robbery, and gave 300 to a beneficiary to whom it was due. In the account he takes credit for both the last two outgoings, for the 200 because trustees are not liable for accidental loss and for the 300 because it was an intra vires disposition, but not for the first. He has nothing left, but he remains accountable for the 500 given to his friend. It can be said that his liability to honour the account arises from the misdisposition, but it is not necessary to say that. He was accountable ab initio for the 1000 and he has discharged himself only in respect of the 200 and the 300.

The beneficiaries can enforce the primary right, and the trustee will then be liable, not because of the wrong as such, but because he cannot, by invoking a wrongful disposition, reduce his primary liability to account and to honour the account. This non-wrong liability is nowadays easily overlooked but it has important consequences for the measure of recovery and onus of proof. As to the latter, it makes the beneficiaries' task easy and will drive an honest trustee to seek to be excused the misdisposition.

## 2 Remedial Rights

In general the law makes wrongdoers pay money to their victims. This can be approached through remedies, in the sense of those orders which a court will make against the wrongdoer, or, better, through the distinction between primary and secondary or remedial rights. By definition, every wrong violates a

primary right. The wrong itself gives rise to secondary rights. The court's order effectuates the secondary rights and creates tertiary rights, which themselves are realized through the machinery of execution. If we know what secondary rights are born of breaches of trust, the rest will more or less take care of itself.

The answer to this question can get much of the way by distinguishing different goals which will be achieved if the right is realized. Secondary or remedial rights are always rights to compensation (money measured by the claimant's loss) or restitution (money measured by the defendant's gain) or to other payments (money measured by some principle which has nothing to do with the claimant's loss or the defendant's gain. These measures have sub-forms. Thus compensation can be calculated from different bases, and restitution can likewise be restrained by more or less restrictive conditions.

In settling which breaches generate which remedial rights certain routine confusions have to be avoided. First, only chaos can attend the continued use of "restitution (of a person to a condition)" to denote a particular measure of compensation for loss. "Restitution (of a thing to a person)" must be kept for those remedial rights which aim to acheve the surrender of a gain. Here "surrender" is carefully chosen, for it extends beyond givings back to include all givings up of a gain. Secondly, nothing good can come from supposing that "equitable compensation" can do anything other than compensate a loss. In short equitable compensation is compensation, and compensation is the making good of a loss. The question after remedial rights is a simple question after rights to compensation of losses, rights to restitution of gains, and rights to awards calculated on other principles.

The chancery hid its practice of compensating losses behind the language of account. That is to say, it achieved compensation by making trustees accountable for assets which they had lost or had failed to receive. The unmasking of that practice provides no warrant whatever for recognizing a measure of compensation which goes beyond making good a loss, which would be a contradiction in terms. This does not deny that there are species within the genus. The loss can be measured from different bases. The amount of compensation will differ according to the base from which the loss is measured. But the species of compensation do not immediately fall to be considered. The question at the first level is simply whether the breach gives rise to a remedial right measured as compensation, as restitution, or by reference to some other goal. That is the controlling question. Only at the next level down come further questions as to different measures of loss to be compensated or gain to be surrendered.

The paragraphs immediately above are concerned with secondary or remedial rights arising from breaches of trust conceived as a wrong. They say nothing of the liabilities which arise independently of wrongs. Where a primary right is directly enforced (where "directly" means without recourse to an obligation arising from the wrong consisting in its infringement or the unjust enrichment arising from the receipt of the thing in question) the questions relating to these measures are irrelevant, for what the claimant will get will simply

be the fulfilment of the primary right. One who gets specific performance of a contract, for example, simply gets his right realized. One who obtains payment of a debt is not being compensated for loss arising from a breach of duty. He is merely obtaining the sum due.

## 3 Proprietary Rights

Trust assets are constantly turned over. That is, they are invested and reinvested. That is normal. We are interested in the pathology. What exactly happens when the assets in question are disposed of in breach of trust? The answer has to be divided into two parts. There is the condition of the asset in the hands of the recipient, and, unless the disposition is gratuitous, there is the status of traceable substitute in the trustee's hands.

On one recent view the right in the original simply detaches and latches on to the substitute, much as a leech moves to a new leg. Only the leech interpretation of the behaviour of property rights in this situation turns out not to work. Moreover it traps people into thinking that there is nothing to explain. But closer analysis suggests the necessity of identifying unauthorized substitution as an event creative of new property rights. And once it has been identified it has to be understood. Does it operate in this way in its character as a wrong, or does it operate as an unjust enrichment at the expense of the beneficiaries? The answer may of course be neither, in which case we would have to say that it has a reason all its own.

## 4 Third Parties

No area has been more beset by outdated linguistic formulae. To say of someone who has induced or assisted a breach of trust that he is accountable as a constructive trustee is only to attach a label the function of which was to justify the exercise of chancery jurisdiction over him. Nowadays no good purpose is served by deeming him to be trustee and no help can be derived from describing him as accountable. The accessory to the breach of trust commits a wrong, and that wrong generates secondary or remedial rights in the same way as any other wrong. The law's business is to define the wrong and to decide whether in this case the victim may choose from the full range of known remedial rights or only from a more restricted menu. Fortunately in relation to this wrong the modernization of the law has recently proceeded apace. The old language is already falling away. It is within the context of that successful example of modernization that Dr Mitchell presents his comprehensive study of the wrong in this volume.

That success story has so far not been repeated in relation to the old figure of "knowing receipt." A recent opportunity was thrown away. Once again nothing

is gained by calling the recipient of trust property a constructive trustee. The word "accountable" is a shade less unsuitable, given that the recipient does indeed receive something of which to be accountable. But accountability does not convey any certain message about the nature of the recipient's liability. The traditional name "knowing receipt" is tendentious in asserting that knowledge of the trust provenance is a precondition of the recipient's liability. Nothing is clearer therefore than that the modernization of this figure will not be achieved without rising above the language which has so long been in use.

The necessary pattern of the modernization has become tolerably clear. First a distinction must be drawn between personal and proprietary liability. The personal liability of the recipient can arise in the law of wrongs or the law of unjust enrichment. The former liability might be expected to include a requirement of fault, and in all likelihood of dishonesty, while the latter will be strict, though fragile in being subject to vigorous defences. The proprietary liability is independent of fault and will lie only where the recipient still has the property received or its traceable proceeds. In the former case the right which the beneficiary acquires in the assets will have arisen with and from the original trust, while in the latter, though this is controversial, it arises from unjust enrichment, for one who acquires an asset with value belonging to another unjustly enriches himself at the expense of that other.

## 5 Reduction of Liability

Reduction of liability for breach of trust is brought about by a number of different mechanisms. It is important that they be brought together, as is attempted in this book. At one end of the spectrum, and increasingly prominent in the modern law where professional trustees are now the common case, is the reduction of liability through exemption clauses. Here the law has recently been developed to match the new conditions. This is, so to say, anticipatory reduction. At the other end of the spectrum, the last recourse for the trustee who has neither the benefit of an exemption clause nor a defence lies in the court's jurisdiction to excuse. A trustee in breach who has acted honestly and reasonably may seek to be absolved. The fact that few cases reach the courts, and fewer still the law reports, does not mean that this jurisdiction is not used. It may inhibit many claims in respect of technical defaults.

In between carefully drafted exemption clauses and the jurisdiction to excuse come the defences. The most troublesome defences have indubitably been those concerned with passage of time and stale claims. Both here and in relation to the defence of consent the problems inherited from the past are exacerbated by the extension of the law of trusts into other areas where persons can be said to occupy trustee-like positions. Although our policy has been to stick to breach of trust and not to chase this extension to other fiduciaries, this exacerbation could not but show through in the treatment of these defences. The Law Commission

made its proposals for the future of the law of limitation at a late stage in the project. Its report allows it to be said that in this field the process of modernization is well under way, and not before time.

The sequence of the Chapters is determined by this five point list of the aspects of the modernization of the law relating to breach of trust, although not every chapter can be said to be confined strictly within one of them. Subject to that caveat, the first two—achieving a better classification of breaches of trust and streamlining the language of the remedial rights arising from breaches—are the province of the first three Chapters (Chambers, Getzler, Simpson). The third—explaining the behaviour of proprietary rights when assets are misapplied—belongs to Chapters 4 and 5 (Fox, Smith). The fourth—overhauling the law and language relating to the liability of third parties who deal with trustees in breach—is covered in Chapters 6 and 7 (Mitchell and Birks). And, the fifth—the reduction of the trustee's liability—falls to the remaining five Chapters (Penner, Lowry and Edmunds, Payne, Swadling, Watt). The book then concludes with Professor Hayton's overview.

D

As editors we have incurred a number of debts. It has been a great pleasure to work with Hart Publishing, now becoming famous for its positive and helpful attitude towards its authors no less than for the brilliant design of the books in its list. Our publishers apart, we would like to express our gratitude to All Souls College for hosting our symposium. It is hard to think of any better place to inquire seriously into the nature of things. We must also thank all those who attended the symposium on 19 April 2001, especially those who came from far away. We know how many and great are the calls on the time of the senior judiciary. The judges who attended did not come as spectators but as working members of the group. Their contribution was invaluable. Special thanks are due to Sir Nicholas Patten, who took the chair. To the Reporter, Professor David Hayton, and to all those who wrote papers and have turned them into chapters, we express our gratitude both for their hard work and their patience during the whole period of this project. Finally, one of us, who was himself far away during many of the crucial months, must thank the other for doing the lion's share of the editors' work.

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15 November 2001

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# 1

# *Liability*

ROBERT CHAMBERS

## A INTRODUCTION

TO SAY THAT trustees are liable for breach of trust is not all that meaningful unless we can also say what they are liable to do. Liability in the abstract depends on three main questions: (1) what duties were the trustees required to perform, (2) did the trustees fail to perform any of those duties properly, and (3) do the trustees have a defence to the liability ordinarily arising from that failure? If these inquiries (into duty, breach, and defence) lead to the conclusion that trustees are guilty of an unexcused breach of trust, it is then necessary to examine the consequences of that breach. There are two additional questions that must be answered: (4) what effect did that failure have on the trust assets, beneficiaries, and trustees and (5) what can be done to correct the situation?

This essay deals with the fifth question, which might be called the legal consequences of, or legal responses to, breach of trust. More accurately, this essay is concerned with the central component of that question: what are trustees liable to do following an unexcused breach of trust? A breach of trust can also create liabilities for others who become involved in the breach, either as accessories or by receiving trust assets. Those liabilities are discussed elsewhere in this book.[1]

A great deal of attention has been paid in recent years to dishonest assistance, knowing receipt, and the tracing and recovery of value misappropriated from trusts. With notable exceptions,[2] the liabilities of the trustees themselves have received much less attention. Of course, the standard works continue to provide very helpful and detailed information about trustee liability,[3] but it has not been subjected to the same searching scrutiny in light of modern developments in the law of obligations. An aim of this essay is to spur a more open discussion of the nature of the liabilities of trustees in breach.

[1] See in this volume P Birks "Knowing Receipt: Re Montagu's Settlement Trusts Revisited" Ch 7; C Mitchell "Dishonest Assistance" Ch 6; L Smith "Property Transferred in Breach of Trust" Ch 5.
[2] Eg, *Target Holdings Ltd v Redferns* [1996] 1 AC 421.
[3] See, eg, J Mowbray et al *Lewin on Trusts* (17th edn Sweet & Maxwell London 2000) 1179–1215.

The main impediment to an open discussion of these issues is the isolation of the law of trusts from other areas of private law. The language and organisation of the law of trusts set it apart from contract, tort, and unjust enrichment. For example, the traditional classification of trusts, as express, implied, resulting, or constructive, makes it hard to compare the creation of trusts with the creation of other legal rights and obligations. Similar problems arise when we try to compare breach of trust with other legal wrongs, such as breach of contract or tort. While the contract breaker or tort feasor may be compelled to pay damages, the defaulting trustee may be required to account or pay equitable compensation. Significant progress has been made in relation to the creation of trusts, thanks to a healthy and vigorous debate over the proper classification of trust creating events.[4] The various liabilities for breach of trust are in need of this kind of scrutiny.

The first step is to identify a meaningful basis for comparing liabilities for breach of trust with liabilities for other legal wrongs. At the highest level of generality, all liabilities for breach of duty are means of enforcing duties, either directly or indirectly. They may operate as ways to achieve performance of the duty, as substitutes for performance, or as deterrents to non-performance. At a lower level of generality, liabilities for breach of duty can be organised according to the goals they are supposed to achieve: direct enforcement of the duty, compensation for loss, restitution of gain, punishment, or other goals.[5] This essay adopts this framework.

The bulk of this essay concerns the three main goals of direct enforcement of trust duties, compensation for loss, and restitution of gain. The discussion of each goal begins with some general observations about the goal and how it relates to breach of trust, before dealing with the liabilities and other responses to breach of trust that pursue it. Much less attention is paid to punishment and other goals.

## B DIRECT ENFORCEMENT

In private law, most duties are enforced only indirectly through the payment of money either as a substitute for performance or as a deterrent to non-performance.

[4] See P Birks "Restitution and Resulting Trusts" in S Goldstein (ed) *Equity and Contemporary Legal Developments* (Sacher Institute Hebrew University Jerusalem 1992) 335; P Birks "Equity, Conscience, and Unjust Enrichment" (1999) 23 Melbourne University Law Review 1; P Birks & F Rose (eds) *Restitution and Equity Volume One: Resulting Trusts and Equitable Compensation* (Mansfield London 2000); R Chambers *Resulting Trusts* (Clarendon Oxford 1997); R Chambers "Constructive Trusts in Canada" (1999) 37 Alberta L Rev 173; R Chambers "Resulting Trusts in Canada" (2000) 38 Alberta L Rev 378; G Elias *Explaining Constructive Trusts* (OUP Oxford 1990); P Millett "Restitution and Constructive Trusts" (1998) 114 L Q Rev 399; W Swadling "A New Role for Resulting Trusts?" (1996) 16 Legal Studies 110.

[5] See P Birks "Unjust Enrichment and Wrongful Enrichment" (2001) 79 Texas L Rev 1767, 1772; A Burrows "Judicial Remedies" in P Birks (ed) *English Private Law* (OUP Oxford 2000) vol II, 813, 816.

The exceptions are well known and most relate to rights to land. Most contracts to sell property rights to land are specifically enforceable, while most other contracts are not. Restrictive covenants can be enforced by injunction and wrongful interference with land (trespass or nuisance) can be restrained by injunction. A right to immediate possession of land can be enforced by ejectment or an order to recover land. In contrast, the equivalent rights to goods are usually enforced through the payment of damages, unless the goods are not available in the market place.

There are several different explanations for the special treatment of rights to land, such as the importance of land as a place to live and source of income. The common legal explanation is that each parcel of land is unique. The payment of money is not an adequate substitute for loss of a beneficial interest in land, because an identical interest cannot be found in the market place. Although this explains why the law routinely provides for the direct enforcement of rights to land (and other rare or unique things), instead of substitute performance, it does not explain why most other rights are not enforced directly.

Why is substitute performance the norm in so many areas of law? There are, of course, many situations in which direct enforcement is no longer possible or meaningful. If I breach my duty of care and injure you with my car, the future performance of my duty will not solve the problem I created. However, even where direct enforcement of a duty is possible, it may not be the best form of justice. The cost of performance and the cost of monitoring that performance may outweigh the benefit to the claimant.[6] Compelling the defendant to perform a duty is more likely to cause hardship and loss of liberty for the defendant than will an order to pay a sum of money.[7] The claimant may no longer want performance from the defendant, who has already demonstrated an inability to provide it properly. Better to achieve a final resolution of the dispute and the end of the relationship between the parties through the payment of money, so long as it provides an adequate substitute for performance of the duty breached.

This is another way in which trusts are out of step with other areas of law. Most trust duties are directly enforceable. Although this is a product of a time when most trusts related to land, it does not depend on the nature of the subject matter of the trust. Trusts of commodities or funds can be enforced directly in the same manner as a trust of land.[8]

## 1 Why Are Trust Duties Directly Enforceable?

In *Target Holdings Ltd v Redferns*, Lord Browne-Wilkinson said, "The basic right of a beneficiary is to have the trust duly administered in accordance with

[6] See E Yorio "In Defense of Money Damages for Breach of Contract" (1982) 82 Columbia L Rev 1365.

[7] P Birks "Proprietary Rights as Remedies" in P Birks (ed) *The Frontiers of Liability* (OUP Oxford 1994) vol 2, 214, 218.

[8] A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [199.1], 204.

the provisions of the trust instrument, if any, and the general law."[9] Generally speaking, the legal responses to breach of trust are designed to fulfil this basic right. They do not bring the relationship between the parties to an end, but enable the trust to be carried out as the settlor intended. The trustees' duties can be enforced using declarations, injunctions, directions to perform, or orders to account. When trustees are required to pay money as compensation or restitution, normally it is not paid directly to the beneficiaries, but used to purchase assets for the trust.

There are at least two possible explanations for this departure from the law's normal preference for substitute performance: (1) there are aspects of the law of trusts which alleviate the main objections to the direct enforcement of duties and (2) the payment of money directly to the beneficiaries is not an adequate substitute for the performance of most trusts. First, the continuance of a trust does not necessarily compel the continued relationship between the beneficiaries and defaulting trustees. Trustees can retire or be replaced. Also, it may be possible to vary or terminate a trust if the cost of continued performance outweighs the benefit of that performance.[10] Of these powers, only the replacement of trustees is linked directly to breach of trust. However, the ability to replace trustees or vary or terminate trusts when needed may have created an environment in which the direct enforcement of duties could become the normal response to a breach of trust.

Secondly, in most cases of breach of trust, the payment of money to beneficiaries would not be an adequate substitute for performance of the trust. Most trusts are created for the purpose of managing assets over an extended period of time. Settlors choose to create trusts, rather than make gifts directly to the beneficiaries, for various reasons, such as the prudent management of trust assets, the limitation of the beneficiaries' use of those assets, and the flexibility to provide for the changing needs of beneficiaries. The important factor is that the settlor chose not to make a gift directly to the beneficiaries, but to create a trust for their benefit. If a breach of trust, causing a loss of trust assets, led to the payment of compensation directly to the trust beneficiaries, this would have the effect of collapsing the trust in whole or in part. It is true that the beneficiaries could then use the money to acquire replacement assets and settle them in trust, but this would undo the settlor's allocation of the trust assets and transfer that decision to the beneficiaries.

Also, the payment of money would not substitute adequately for the performance of discretionary trusts or purpose trusts. If the trust gives the trustees a discretion to distribute benefits among a class of beneficiaries, each beneficiary would have standing to sue the trustees for breach of trust, even though he

[9] [1996] 1 AC 421, 434.

[10] Private trusts can be varied under the rule in *Saunders v Vautier* (1841) Cr & Ph 240, 41 ER 482 (with the consent of all the beneficiaries), the Variation of Trusts Act 1958 (UK), or the Trustee Act 1958 (UK), s 57, while charitable trusts can be varied cy près, under the Charities Act 1993 (UK), s 13; see J Penner *The Law of Trusts* (2nd edn Butterworths London 2000) 303–7, 429–34.

or she might never receive any actual benefit from the trust. Although it would be possible to calculate the value of each beneficiary's interest in the trust, based on the chance that he or she might benefit from it, a distribution of trust value thinly among the beneficiaries would defeat the purpose and utility of a trust designed to concentrate limited resources where they are needed most. As Lord Wilberforce said in *McPhail v Doulton*, "equal division among all may, probably would, produce a result beneficial to none."[11]

Trusts for purposes are not enforced by the people who might benefit from the fulfilment of those purposes. Instead, trusts for charitable purposes can be enforced (on behalf of the Crown) by the Attorney-General or Charity Commissioners,[12] while trusts for non-charitable purposes (if valid) can be enforced by the persons entitled to the remainder of the trust assets upon completion of the trust.[13] In other words, the people who hold the rights that correspond to the trustees' duties to perform the trusts are not intended to derive any benefit from the performance of the trust. The payment of money to them does not provide any meaningful substitute for the proper performance of the trust.

## 2 Primary and Secondary Duties

The direct enforcement of trust duties is different from all other consequences of breach of trust. The duties enforced (and corresponding rights to enforce those duties) are the primary duties (and rights) that arose when the trust was created. Although a breach of trust is the reason for seeking the court's help to enforce a particular duty, the duty exists independently of the breach. In contrast, the other consequences of breach of trust are secondary duties (and rights) created by the breach.[14]

Primary trust duties are created by the settlor and the law applicable to that trust. Within fairly broad limits, the settlor is free to impose whatever duties the trustees are willing to accept. The law supplements them with a standard set of duties normally applicable to all express trustees, such as the duty to exercise their discretion loyally for the purpose of best accomplishing the objectives of the trust. However, most of the standard duties are merely default rules, which the settlor can exclude when the trust is created.[15] According to Millett LJ in *Armitage v Nurse*, "there is an irreducible core of obligations owed by the

[11] [1971] AC 424, 451.
[12] *A-G v Alford* (1855) 4 De GM & G 843, 43 ER 737; Charities Act 1993 (UK).
[13] *Re Astor's Settlement Trusts* [1952] Ch 534; also see *Wood v R* [1977] 6 WWR 273, 280–1; D Hayton "Developing the Obligation Characteristic of the Trust" (2001) 117 L Q Rev 96.
[14] P Birks "Rights, Wrongs, and Remedies" (2000) 20 Oxford Journal of Legal Studies 1, 12; P Birks "Three Kinds of Objection to Discretionary Remedialism" (2000) 29 University of Western Australia L Rev 1, 4.
[15] See in this volume J Penner "Trustee Exemption Clauses after *Armitage v Nurse*" Ch 8; Trustee Act 2000 (UK), sch 1, s 7.

trustees."[16] He identifies this core in general terms as the duty "to perform the trusts honestly and in good faith for the benefit of the beneficiaries."[17] Along with (or as part of) this general duty, there are specific duties which all express trustees are required to perform, such as the duty to provide information to the beneficiaries (discussed below). Beyond the core (however defined), the trust duties are selected by the settlor, either positively (as terms of the trust) or negatively (as default rules not excluded from the trust).

The primary duties owed by trustees following a breach of trust are more or less unaffected by the breach and its consequences, which create and define the trustees' secondary duties, if any. Some consequences, such as the destruction of trust assets, may render the future performance of primary duties impossible or meaningless. However, so long as performance of the trust is possible, the trust duties will continue to exist and can be enforced.

Normally, it is fairly easy to tell whether a trust duty is a primary duty created by the settlor or a secondary duty created as a consequence of an unexcused breach of trust. However, this distinction can be difficult to make, especially in relation to the trustees' duty to account. Trustees have a primary duty to provide information to the beneficiaries (or other persons entitled to enforce the trust), but can also have a secondary duty to account created by a breach of trust. As discussed further below, this distinction is important, because the secondary duty is the legal consequence of an unexcused breach of trust with certain factual consequences, while the primary duty exists independently of the breach.

Some responses to breach of trust look like the direct enforcement of trust duties, because they lead to the performance of those duties. For example, the replacement of trustees in breach will transfer the trust assets to people who will accept and perform the primary duties created by the settlor. However, the replacement itself is not direct enforcement, because the original trustees do not owe a primary duty to be replaced. It arises as a consequence of the breach and is discussed below as one that pursues a goal other than direct enforcement, compensation, restitution, or punishment. This is also true of the administration of the trust by the court or the appointment of a receiver.

## 3 Methods of Enforcing Trust Duties

There are two main ways to enforce primary trust duties. First, trustees can be compelled to do something required by the trust (by order to account, direction, or declaration). Secondly, trustees can be prevented from doing something prohibited by the trust (by injunction or declaration).

[16] [1998] Ch 241, 253.

[17] *Armitage v Nurse* (n 16 above) 253.

*(a) Account*

There are three forms of account (common account, account on the basis of wilful default, and account of profits) that are used to pursue three main goals (direct enforcement, compensation, and restitution). There is some correlation between the three forms of account and the three goals they pursue, but it is imperfect and, therefore, potentially misleading. A common account is used to compel trustees to perform their primary duties, an account of the basis of wilful default is used to obtain compensation for loss, and an account of profits is used to obtain restitution of gain. However, a common account can also be used to obtain compensation and the other two forms of account also provide direct enforcement of primary duties. All three forms of account are used to enforce two important trust duties: to provide information and to pay money.

(i) Duty to Inform The trustees' duty to provide information to the beneficiaries (or others entitled to enforce the trust) is a primary duty to account for their management of the trust. This is one of their core duties that cannot be removed by the settlor.[18] It has two components. First, trustees must keep accurate records of all their dealings with trust assets, including any documents (such as receipts) needed to validate those records.[19] Secondly, trustees must provide relevant information to the beneficiaries on demand or when it is in the interests of the beneficiaries to do so.[20] The beneficiaries are entitled to reasonable access to trust documents and to make copies (at their own expense).[21] This includes all documents related to the management of the trust, except communication among the trustees themselves concerning their exercise of a discretionary power.[22]

When ordered to account, the trustees must provide the court with an account (in the required form) of all receipts and disbursements of trust assets. The onus is on the trustees to prove and justify their account. A failure to keep or produce adequate records will lead to the usual presumptions against wrongdoers: any uncertainty will be resolved adversely to the trustees.[23] This does not mean that documentary evidence is always required. In *Morley v Morley*,[24] a trustee was robbed by his servant of £40 in gold held in trust. The

[18] *Jones v Shipping Federation of British Columbia* (1963) 41 WWR 636 (BC); D Hayton "Developing the Obligation Characteristic of the Trust" (2001) 117 L Q Rev 96, 104–5.

[19] GG Bogert and GT Bogert *The Law of Trusts and Trustees* (rev 2nd edn West St Paul Minn 1983) [962]; R Meagher and W Gummow *Jacobs' Law of Trusts* (6th edn Butterworths Sydney 1997) [1713].

[20] *Re Dartnall* [1895] 1 Ch 474 (CA); *Re Webb* [1894] 1 Ch 73, 79–80 (CA); Bogert (n 19 above) [961].

[21] *Sandford v Porter* (1889) 16 OAR 565 (Ont CA).

[22] *Re Londonderry's Settlement* [1965] Ch 918; *Hartigan Nominees Pty Ltd v Rydge* (1992) 29 NSWLR 405; *Wilson v Law Debenture Trust Corp* [1995] 2 All ER 337; also see *Wells Fargo Bank NA v Superior Court of Los Angeles County*, 990 P2d 591 (Cal 2000) regarding privileged communication between trustees and their solicitors.

[23] Bogert (n 19 above) [962], 20–23.

[24] (1678) 2 Ch Cas 2, 22 ER 817.

robbery was proved only by the trustee's oath and he was allowed to claim a disbursement of £40 on the account. Also, the court can dispense with an account in exceptional circumstances. In *Campbell v Gillespie*,[25] the beneficiary led the trustee to believe that the trust had been completed satisfactorily and that no further account would be required. The trustee then destroyed the trust records, which was improper, but done honestly. The court dismissed the beneficiary's application for an account.

Normally, beneficiaries are entitled to information about the trust without court order.[26] Regardless of the form required, an order to account directly enforces the trustees' primary duty to provide that information, at least so far as it concerns the use of trust assets. As discussed below (in the section on restitution), trustees can also be required to account for profits earned, without the use of trust assets, from personal activities that conflict with their duty of loyal service to the trust. Since trustees are not required to provide beneficiaries with information regarding all aspects of their lives, the duty to account for otherwise unrelated activities must be created by the breach of their duty of loyalty. In other words, it is not a primary, but a secondary duty to provide information.

When faced with a choice between two inconsistent responses to breach of trust, beneficiaries are entitled to receive any information needed to make the most advantageous choice. For example, if trustees misappropriated trust assets, the beneficiaries could choose either compensation for the loss to the trust or restitution of the gain to the trustees (as discussed below). Before making this choice, they are entitled to accounts of that loss and gain. As James LJ said in *Vyse v Foster*, "if the Plaintiff is entitled to any election at all, she would have a right, at all events, to have such an inquiry and accounts as would enable her to determine her election."[27]

(ii) Duty to Pay An order to account is the standard method of enforcing the trustees' duty to pay money to the beneficiaries or into a trust account. This is done by combining the order to account with an order to pay any sum found to be due when the accounting process is complete. It is important to note that, in many cases, the order to pay will effect compensation or restitution rather than direct enforcement. This depends on whether the trustees have a primary duty to pay that sum or have become liable to pay it only because they have breached another trust duty. If the duty exists only because of a breach of trust, it is a secondary duty, regardless of whether it is enforced by an order to account or some other means.

It is a basic principle of trust law that trustees who properly perform their trusts should not be out of pocket for doing so. They might not be entitled to

[25] [1900] 1 Ch 225.

[26] But see Bogert (n 19 above) [961], 12.

[27] (1872) 8 Ch App 309, 334; see A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [205], 240.

remuneration for their services, but are entitled to be reimbursed for all reasonable expenses incurred to perform the trust.[28] Even where a trust suffers substantial loss, the trustees are not liable to contribute from their own resources, unless they breach the trust and that breach causes the loss. As Lindley LJ said:

> [A] trustee is not a surety, nor is he an insurer; he is only liable for some wrong done by himself, and loss of trust money is not per se proof of such wrong. . . . Trustees acting honestly, with ordinary prudence and within the limits of their trust, are not liable for mere errors of judgment. Any loss sustained by the trust estate under such circumstances falls upon and most be borne by the owners of the property—ie, the cestuis que trust—and cannot be thrown by them on their trustees, who have done no wrong, though the result may prove that they possibly might have done better.[29]

Unless trustees have breached their trust in some way, it should contain the assets needed to satisfy any order to account and pay. Trustees cannot be compelled to reach into their own pockets without proper justification. In most cases, that justification is a breach of trust causing either loss to the trust or gain for the trustees. There are other justifications, but they also involve a breach of trust. For example, if trustees breach their duty to keep adequate records, they might be unable to verify otherwise legitimate disbursements and therefore required to reimburse the trust for the money spent. Also, if trustees incur expenses on behalf of the trust which are unreasonable, they will not be entitled to reimbursement because that would be a misuse of trust assets and therefore a breach of trust.

Professor Birks has taken a position contrary to this, arguing that trustees, who make an unauthorized disposition of trust assets, can be required to pay for that loss as part of their primary duty to account:

> There is a double obligation born of the receipt of property on trust, to account and to honour the account. That is not to say that the ultra vires dispositions are not wrongs. They are. But their character as breaches of duty is not relevant to the state of the account. In other words, the trustee is not liable under this head for the wrong but liable because he received the given sum as a trustee and, in taking the account, he may not take credit for an ultra vires disbursement or an ultra vires investment.[30]

However, a disbursement is disallowed, not because it is unauthorized or ultra vires, but because it was made in breach of trust. If trustees are robbed of trust assets, they are entitled to enter the loss as a disbursement on the account, so long as the robbery occurred without their fault.[31] Although the disbursement was not authorized or intra vires, there was no breach of trust and, therefore,

[28] *Re Harrison's Settlement Trusts* [1965] 1 WLR 1492, 1497; Trustee Act 2000 (UK), s 31(1).
[29] *Re Chapman* [1896] 2 Ch 763, 775–6 (CA); see also *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 Ch 515, 530–1; *Target Holdings Ltd v Redferns* [1996] 1 AC 421, 432; Scott (n 27 above) [204].
[30] P Birks "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26 University of Western Australia Law Review 1, 47; also see P Birks "Definition and Division: A Meditation on *Institutes* 3.13" in P Birks (ed) *The Classification of Obligations* (Clarendon Oxford 1997) 1, 25.
[31] *Morley v Morley* (1678) 2 Ch Cas 2, 22 ER 817.

the trustees are not liable to pay for it. Of course, if they did breach their trust, the outcome would be different. The disbursement could be disallowed if they failed to safeguard the assets adequately and, if they failed to insure the assets, the account could be surcharged by the amount that should have been received from an insurer. The adjustment of accounts is discussed further in the section on compensation below.

### *(b) Direction*

The court can order trustees to perform their duties if they fail to do so without excuse. The order usually takes the form of a direction that the trustees perform a particular action.[32] Although Bogert calls this "specific performance,"[33] most commentators use other phrases, such as "specific enforcement"[34] or "to compel performance,"[35] probably because specific performance is so closely associated with the direct enforcement of contractual obligations. Nevertheless, it is uncontroversial that a court of equity can order trustees to perform specific trust obligations even though those obligations are non-contractual. The main difference between the specific performance of contracts and trusts is that contracts are enforced directly only when damages are inadequate, while trusts are enforced without regard to the adequacy of other remedies.[36]

Normally, a court will not compel trustees to exercise their discretion in a particular way,[37] but can do so if they fail to exercise it properly or at all.[38] As discussed below, the court can also enjoin trustees from exercising their discretion improperly or remove them if they refuse to exercise it at all.

### *(c) Injunction*

The court may grant an injunction restraining trustees from using or dealing with trust assets in a way which would breach the trust, such as a use of trust assets for improper purposes, sale at an undervalue, or transfer to the wrong person.[39] This is the direct enforcement of trust duties not to do certain things. Like the specific performance of trust duties, an injunction restraining a threatened breach of trust is available regardless of the adequacy of other remedies. However, in *Buttle v Saunders*,[40] Wynn-Parry J decided not to grant an injunc-

32 See, eg, *Re Tillott* [1892] 1 Ch 86.
33 GG Bogert and GT Bogert *The Law of Trusts and Trustees* (revised 2nd edn West St Paul Minn 1995) [861], 21.
34 A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [199.1].
35 R Meagher and W Gummow *Jacobs' Law of Trusts* (6th edn Butterworths Sydney 1997) [2303].
36 Scott (note 34 above); Bogert (note 33 above) [870], 135–7.
37 *Tempest v Lord Camoys* (1882) 21 Ch D 571 (CA); *Re Blake* (1885) 29 Ch D 913 (CA).
38 *Re Hodges* (1878) 7 Ch D 754; *Klug v Klug* [1918] 2 Ch 67; Scott (n 34 above) [187.1]-[187.5].
39 *Wylde v A-G (NSW)* (1948) 78 CLR 224, 270; *Buttle v Saunders* [1950] 2 All ER 193; *A v C* [1981] QB 956, 959; Bogert (n 33 above) [861], 12–15; Scott (n 34 above) [199.2].
40 [1950] 2 All ER 193.

tion restraining the trustees from selling at an undervalue, after they agreed to follow his direction to sell at the proper value.

### *(d) Declaration*

A court can also enforce trust duties by making a declaration that trustees should act or not act in certain ways. For example, in *Cowan v Scargill*, Megarry V-C declared that half of the trustees of a pension fund were in breach of trust by refusing to concur with the other half in the adoption of an investment strategy and business plan.[41] Although a declaration might be regarded as a method of enforcement that is less direct than specific performance and injunction, it has substantially the same effect of compelling trustees to do their duty. As Megarry V-C said in *Cowan v Scargill*, when choosing between giving directions to the trustees or making declarations:

> I think that at this stage it would be more appropriate for me to make declarations, and leave it to the defendants to carry out their duties as trustees in accordance with those declarations. I am ready to assume that they will comply with the law once the court has declared what it is. . . . I shall not assume that the defendants intend to demonstrate their unfitness to continue as trustees by refusing to comply with the law as declared by the court.[42]

## C COMPENSATION

Although most trust duties can be enforced directly, trustees can also be compelled to pay compensation for loss. As in other areas of law, the liability to compensate is created and measured by the loss caused by the breach of duty. Since express trusts involve the performance of positive duties and not just the avoidance of harm (even a bare trust requires trustees to preserve the trust assets and transfer them on request), the loss caused by the breach is measured against the position that would have been attained if the trust had been performed properly (like damages for breach of contract).[43]

Many trusts give the trustees a wide discretion to manage trust assets. If the trustees breach the trust, say by making an improper investment, it can be difficult to predict the outcome of proper performance. The loss will not be measured by reference to a particular possible investment unless the trustees were required to make that investment.[44] When faced with this uncertainty, the court might calculate the loss with reference to the trustees' most probable use of the trust assets if they had acted properly. Alternatively, the court might simply

[41] [1985] Ch 270, 286, 299.
[42] [1985] Ch 270, 296.
[43] See *Bartlett v Barclays Bank Trust Co Ltd* [1980] 1 Ch 515, 535.
[44] *Shepherd v Mouls* (1845) 4 Hare 500, 67 ER 746.

order the repayment of the money with interest set to compensate for loss to the trust. The beneficiaries bear the onus of proving the loss to the trust.[45] However, once the beneficiaries have proved, on a balance of probabilities, that the trust has suffered a loss, the court may be willing to make presumptions to help the beneficiaries determine the amount of loss.[46]

Compensation for breach of trust has the same goal as compensation for other legal wrongs: it provides a substitute for proper performance of the duty. For many legal wrongs, such as a tortious bodily injury, money is a poor substitute. For most breaches of trust, it is a very good substitute, when paid into the trust. The money is used to acquire the assets that would have been held in trust if the trustees had performed their duties properly. It is then possible for the management of the trust to continue as if the breach had not occurred. Of course, if a breach of trust causes the loss or destruction of rare or unique assets (or the trustees become insolvent), compensation will be an imperfect substitute for proper performance of the trust.

## 1 Trust Law vs Common Law

Although all forms of compensation share a common goal, compensation for breach of trust differs from compensation at common law in three notable respects. First, as mentioned above, compensation for breach of trust is not paid directly to the beneficiaries in most cases, but used to acquire additional trust assets.[47] Compensation will be paid to the beneficiaries when the restoration of the trust is not practical or will not undo the effects of the breach (for example, when the trust has come to an end or a beneficiary's interest in the trust has ceased).[48]

Secondly, the method of calculating the loss caused by a breach of trust can differ from methods used in other areas of law. The loss is calculated as of the date of judgment,[49] rather than the date of breach, because (in most cases) the money will be used to acquire trust assets and permit the future proper performance of the trust. It is not clear whether beneficiaries have a duty to mitigate their loss,[50] but in most cases they will have no power to do so. They have a continuing right to insist on proper performance of the trust and compensa-

[45] *Nestle v National Westminster Bank plc* [1993] 1 WLR 1260, [1994] 1 All ER 118, 126–7 (CA).

[46] *Guerin v The Queen* [1984] 2 SCR 335, 13 DLR (4th) 321; *Nestle v National Westminster Bank* (n 45 above) 141.

[47] Eg, *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] 1 Ch 539, 545.

[48] *Target Holdings Ltd v Redferns* [1996] 1 AC 421, 435.

[49] *Target Holdings* (n 48 above) 437.

[50] See J Mowbray et al *Lewin on Trusts* (17th edn Sweet & Maxwell London 2000) 1195; J Getzler "Equitable Compensation and the Regulation of Fiduciary Relationships" in P Birks and F Rose (eds) *Restitution and Equity Volume One: Resulting Trusts and Equitable Compensation* (Mansfield London 2000) 235, 245.

tion is calculated to provide a substitute for that right (as are damages for breach of a specifically enforceable contract).[51]

Also, trust law does not limit the amount of loss to the same extent as the common law. It uses a "but for" test of causation, ignoring issues of remoteness and foreseeability of harm.[52] As Lord Browne-Wilkinson said in *Target Holdings Ltd v Redferns*:

> [T]he common law rules of remoteness of damage and causation do not apply. However there does have to be some causal connection between the breach of trust and the loss to the trust estate for which compensation is recoverable, viz. the fact that the loss would not have occurred but for the breach.[53]

Thirdly, trust law and common law rely on different methods of achieving compensation. The payment of damages is the normal method of compensating for breach of contract or tort, while the account is the normal method of compensating for a breach of trust. By falsifying or surcharging trust accounts, trustees can be made to pay compensation for losses caused by their breach of trust. Trustees can be compelled to pay equitable compensation directly to the beneficiaries in certain situations and, as at common law, awards of interest can be compensatory. These mechanisms are discussed below.

## 2 Compensation vs Restitution

Despite the differences among the various forms of compensation, all pursue the same goal in the same basic manner. The wrongdoer is compelled to pay a sum of money to compensate for the loss caused by her or his breach of duty. The loss both creates the liability to pay and determines the amount to be paid. Although the calculation of loss may differ from one wrong to another, it is the focus on loss that sets all forms of compensation apart from other responses to breach of duty.

Unfortunately, differences in terminology obscure the essential similarities among various forms of compensation. While compensation for breach of contract or tort is called "damages," compensation for breach of trust is often called "restitution." For example, in *Re Dawson*, Street J said:

> The obligation of a defaulting trustee is essentially one of effecting a restitution to the estate. The obligation is of a personal character and its extent is not to be limited by the common law principles governing remoteness of damage.[54]

[51] See A Burrows *Remedies for Torts and Breach of Contract* (2nd edn Butterworths London 1994) 109–111.
[52] *Clough v Bond* (1838) 3 My & Cr 490, 496, 40 ER 1016, 1018; see Getzler (n 50 above); A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [205.1].
[53] [1996] 1 AC 421, 434.
[54] [1966] 2 NSWR 211, 214.

There are three reasons why this use of the terms "damages" and "restitution" might be confusing: (1) the same kind of response to breach of duty goes by different names, depending on the nature of the duty, (2) neither label clearly conveys the idea of compensation for loss, and (3) restitution is now used as a term of art to describe responses that require defendants to give up gains received. For many lawyers, compensation and restitution are contrasting terms that describe discrete categories of legal responses: the former are created and measured by the claimant's loss while the latter are created and measured by the defendant's gain.

Why has compensation for breach of trust been called restitution? There are at least two possible reasons. First, the word "restitution" has more than one meaning.[55] *The Oxford English Dictionary* defines it as "The action of restoring or giving back something to its proper owner, or of making reparation to one for loss or injury previously inflicted."[56] The first half of this definition is the sense in which restitution is understood in modern private law, while the second half is merely a synonym for compensation and is avoided by lawyers who use compensation and restitution as terms of art. However, restitution has another meaning that aptly describes the normal method of compensating for breach of trust: "The action of restoring a thing or institution to its original state or form."[57]

When a breach of trust causes a loss of trust assets or their value, the trustees are required to replace those assets or increase the value of the trust to the level that would have been attained if the breach had not occurred. Although this might be described as restitution, in the sense that the trustees must restore the trust to its original (or proper) state, it is compensation and not restitution as those terms are used by lawyers today. The trustees must pay the cost of correcting the trust, even though they derived no benefit from the breach. In other words, the liability is created and measured by the loss to the trust and not by the gain to the trustees.[58]

The second reason for describing compensation for breach of trust as restitution is that trustees do have an obligation to make restitution of any gains made from a breach of trust. Many breaches of trust involve a misappropriation of trust assets by the trustees, producing both a loss for the trust and a gain for the trustees. There is no doubt that the defaulting trustees have an obligation to make restitution of the misappropriated assets (or their traceable proceeds). However, they also have an obligation to make compensation for the loss caused to the trust.

When dealing with this situation, judges often spoke of the trustees' duty to make restitution, but did not always say clearly whether this meant the trustees'

[55] P Birks "Three Kinds of Objection to Discretionary Remedialism" (2000) 29 University of Western Australia L Rev 1, 2.
[56] J Simpson and E Weiner (eds) *The Oxford English Dictionary* (2nd edn Clarendon Oxford 1989).
[57] *The Oxford English Dictionary* (n 56 above).
[58] *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] 1 Ch 539, 545.

duty to give up the misappropriated assets (or their value) or their duty to make good the loss inflicted upon the trust. A proper understanding of these cases requires close attention to the context in which the term "restitution" is used. In *Re Dawson* (quoted above), Street J used "restitution" to mean the obligation to restore the trust to its original condition (ie, compensation). In other cases, "restitution" was used in its modern sense to mean the obligation to give up assets misappropriated from the trust. For example, in *Re Collie*, James LJ said:

> The Court of Chancery never entertained a suit for damages occasioned by fraudulent conduct or for breach of trust. The suit was always for an equitable debt or liability in the nature of debt. It was a suit for the restitution of the actual money or thing, or value of the thing, of which the cheated party had been cheated.[59]

There are cases where the use of "restitution" remains equivocal, even after careful consideration of the context. For example, in *Target Holdings Ltd v Redferns*, Lord Browne-Wilkinson said:

> [A] trustee in breach of trust must restore or pay to the trust estate either the assets which have been lost to the estate by reason of the breach or compensation for such loss. Courts of Equity did not award damages but, acting in personam, ordered the defaulting trustee to restore the trust estate . . . If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed.[60]

In this quotation, Lord Browne-Wilkinson may be using compensation and restitution as contrasting terms of art, with compensation for loss as a necessary alternative to restitution of gain when the trustees no longer have the trust assets or their value (and therefore nothing to give up). However, the phrase "specific restitution of the trust property" may mean "restitution of the trust to its original condition" rather than "restitution of specific assets to the trust." If so, then restitution and compensation are merely different forms of compensation for loss. The trustees are required to purchase assets to replace those lost because of their breach, regardless of whether the trustees received any benefit from the breach. If assets cannot be replaced in kind, then money is added to the trust as a substitute.

Normally, trustees will be liable to compensate the trust for any loss caused by their breach of trust, regardless of whether they derive any benefit from the breach. As Vinelott J said in *Re Bell's Indenture*:

> In my judgment no valid distinction can be drawn between the position of a trustee who has misappropriated for his own benefit and a trustee who has deliberately misappropriated trust moneys for the benefit of someone else. It would to my mind be absurd to impose a lesser liability to a trustee who has deliberately misappropriated trust moneys by paying them to, for instance, his wife or children.[61]

59 (1878) 8 Ch D 807, 819 (CA).
60 [1996] 1 AC 421, 434.
61 [1980] 3 All ER 425, 441.

Nevertheless, it should not be forgotten that trustees in breach of trust may have a duty to make restitution of gain as well as (or as an alternative to) a duty to make compensation for loss. The beneficiaries may have property rights to restitution of misappropriated trust assets (or their traceable proceeds), which become especially important if the trustees are insolvent. Also, the trustees' gain may exceed the loss to the trust, in which case restitution will be the more attractive option. Finally, it is conceivable that an exemption clause might protect trustees from liability to compensate for loss, but not from liability to make restitution of their gains.

## 3 Methods of Compensation

There are three main ways to obtain compensation for breach of trust: account, equitable compensation, and interest. Awards of interest are straightforward, but there is some potential confusion over the other two. First, with all the attention paid to equitable compensation in recent years, there is a growing misperception that it is the main method of compensating for loss caused by breach of trust. However, it is used for that purpose only when the account is not appropriate.

Secondly, there are two forms of account used to obtain compensation: the common account and the account on the basis of wilful default. A potential misunderstanding about the nature of each form can lead to a false impression that the common account is used only to enforce the trustees' primary duty to account, while the account on the basis of wilful default is used to enforce their secondary duty to compensate for loss. However, the latter account has a rather limited role and the former is the main form used to enforce both primary and secondary trust duties. These issues are discussed below.

### *(a) Account*

When a breach of trust causes loss, the normal way to obtain compensation from the trustees is by taking an account, adjusting it by the amount of loss, and requiring the trustees to pay the difference.[62] Where the trustees have failed to acquire assets or obtain value through proper investments, the account can be surcharged to add the values that would have been attained if the trust had been performed properly.[63] Where the trustees dispose of assets in breach of trust, the account can be falsified, thereby deleting improper disbursements and requiring trustees to reimburse the trust for the value lost.[64]

As discussed below, when trustees make an improper investment, the beneficiaries can choose whether to adopt or reject it. If rejected, the account is falsi-

[62] See A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [205].
[63] Eg, *Matter of Estate of Janes*, 90 NY2d 41, 681 NE2d 332 (CA 1997).
[64] See *Pitt v Cholmondeley* (1754) 2 Ves Sen 565, 28 ER 360.

fied and the investment is deleted from the list of disbursements. The trustees are thereby required to repay the amount spent improperly, with interest, but keep the investment for themselves, subject to a lien to secure their obligation to repay the trust.[65]

Normally, the trustees bear the onus of justifying their account, first with an affidavit verifying the account and, if requested, through inspection of supporting documents. The beneficiaries can object to the account in writing, contending that items are missing or incorrect,[66] and, if their objections are upheld, the account is adjusted accordingly. Where beneficiaries seek to disturb a previously settled account, they bear the onus of proving that it should be falsified, surcharged, or re-opened.[67] If they can establish that it contains an error, the court will allow it to be falsified or surcharged. If it can be shown that the settlement of the account was improperly obtained (by mistake, under undue influence, in breach of fiduciary duty, etc), the account will be re-opened and taken again in the normal manner.[68] Of course, courts are reluctant to re-open accounts that have been settled for a long time.[69]

(i) Common Account The common account is, as the name suggests, the most common form of account. It is available, without any allegation of wrongdoing, to enforce the trustees' primary duty to provide information to the beneficiaries (as discussed above). It is also the standard way to compel trustees to pay compensation for losses caused by breach of trust. The breach may come to light during the accounting process, in which case the beneficiaries will be entitled to seek appropriate relief (amending or commencing pleadings as necessary).[70] If the beneficiaries commence an action against the trustees for breach of trust, a common account can be requested and then falsified or surcharged to obtain compensation.[71]

A misperception that the common account is used only to enforce the trustees' primary duty to account is created by older cases that limit the beneficiaries' ability to shift from that form to an account on the basis of wilful default during the accounting process. For example, in *Partington v Reynolds*,[72] the plaintiff had obtained a decree against the administrator of an intestate for a common account of his administration. While taking the account, the

[65] *Knott v Cottee* (1852) 16 Beav 77, 51 ER 705; *Re Salmon* (1889) 42 Ch D 351, 356–7; *Foskett v McKeown* [2001] 1 AC 102, 130–2; GG Bogert and GT Bogert *The Law of Trusts and Trustees* (rev 2nd edn West St Paul Minn 1983) [865]; Scott (n 62 above) [210].

[66] See CPR, PD 40 (Accounts, Inquiries, etc); Alberta Rules of Court, r 422; A Nevill and A Ashe *Equity Proceedings With Precedents (New South Wales)* (Butterworths Sydney 1981) [312].

[67] *Pitt v Cholmondeley* (1754) 2 Ves Sen 565, 28 ER 360.

[68] *Coleman v Mellersh* (1850) 2 Mac & G 309, 42 ER 119; *Re Webb* [1894] 1 Ch 73, 80 (CA).

[69] *Pitt v Cholmondeley* (1754) 2 Ves Sen 565, 28 ER 360.

[70] *Gordon v Gonda* [1955] 2 All ER 762, 768 (CA).

[71] *Re Wrightson* [1908] 1 Ch 789, 799–800; also see *Re Stevens* [1898] 1 Ch 162, 169–70, 172 (CA).

[72] (1858) 4 Drew 253, 62 ER 98.

plaintiff discovered that the administrator may have been guilty of wilful default, asked for an account on that basis, and was denied. Kindersley V-C said:

> There are two different modes of accounting . . . and accordingly there are two different forms of decree in use to compel him to account. The one is a decree compelling him to account only for what he has received of the testator's or intestate's personal estate; the other is a decree compelling him to account, not only for what he has received, but also for what he might, without his wilful neglect or default, have received, although he has not received it. These are two perfectly different decrees. It is not merely that the latter is a modification of the former; they are totally distinct from each other in principle. They proceed on totally distinct grounds. The one supposes no misconduct; the other is entirely grounded on misconduct.[73]

This does not mean that the common account cannot be used to compensate for breach of trust. It means simply that an account on the basis of wilful default is itself a response to a particular form of wrongdoing and is not available unless that wrong is pleaded and proved (as discussed below). Where the beneficiaries do not allege any wrongdoing, but merely seek an account from the trustees, they cannot obtain an account on the basis of wilful default, or any other form of relief for breach of trust, unless they amend their pleadings accordingly.[74] Like any parties to litigation, the trustees are entitled to know what allegations are made against them and have an opportunity to respond. At one time, the rigidity of Chancery procedure meant that an inability to shift from one form of account to the other could be a substantial hurdle for persons seeking accounts. Today, that shift is not difficult, so long as it is supported by the pleadings (or amendments to pleadings).[75]

(ii) Wilful Default The phrase "account on the basis of wilful default" is not very helpful. It is a term of art in which "wilful default" means simply a failure by trustees, executors, etc, to receive all the assets that they should have received.[76] It does not require intentional wrongdoing: honest, well meaning trustees can be guilty of it.[77] There is some confusion over this because a well known statutory indemnity clause, protecting trustees from liability for the wrongs of their agents or fellow trustees, did not apply if a loss was caused by a trustee's "own wilful default."[78] For that purpose, "wilful default" meant intentional or reckless wrongdoing by the trustee.[79]

[73] *Partington v Reynolds* (1858) 4 Drew 253, 255–6, 62 ER 98, 99; also see *Hodson v Ball* (1842) 1 Ph 177, 182, 41 ER 599, 601.

[74] *Job v Job* (1877) 6 Ch D 562; *Laming v Gee* (1878) 10 Ch D 715; *Mayer v Murray* (1878) 8 Ch D 424; *Barber v Mackrell* (1879) 12 Ch D 534 (CA); *Re Wrightson* [1908] 1 Ch 789, 799.

[75] *Gordon v Gonda* [1955] 2 All ER 762, 768 (CA); see CPR, PD 40 (1.1).

[76] *Armitage v Nurse* [1998] Ch 241, 252; J Stannard "Wilful Default" (1979) 43 Conveyancer 345, 346–8.

[77] *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] 1 Ch 539, 546.

[78] Trustee Act 1925 (UK), s 30; repealed from 1 February 2001 by the Trustee Act 2000 (UK); see Trustee Act 2000 (UK), s 23, regarding the trustee's liability for agents.

[79] *Armitage v Nurse* [1998] Ch 241, 252; Stannard (n 76 above) 348–51.

It is clear that, in the accounting context, "wilful default" is not synonymous with "breach of trust," but is merely one kind of breach.[80] Therefore, the common account is needed to deal with breaches of trust that are not wilful defaults in this technical sense. Further confusion is created by the suggestion that wilful default is distinct from other breaches of trust, because it is "passive" while other breaches are "active". For example, in *Bartlett v Barclays Bank Trust Co Ltd (No 2)*, Brightman LJ said:

> Wilful default by a trustee in this context means a passive breach of trust, an omission by a trustee to do something which, as a prudent trustee, he ought to have done—as distinct from an active breach of trust, that is to say, doing something which the trustee ought not to have done.[81]

However, there are many passive breaches of trust that are failures to act, but not wilful defaults, such as the failure to keep proper records, pay beneficiaries, supervise agents, or insure trust assets. Conversely, a failure to receive assets due to the trust might be a deliberate act of dishonesty by a trustee. The technical meaning of "wilful default" is a failure to receive assets that would have been received if the trust had been performed properly. The adjectives "active" and "passive" do not provide a useful basis for distinguishing it from other breaches of trust.[82]

An account on the basis of wilful default gives the beneficiaries a procedural advantage. The Master has liberty to make a roaming inquiry regarding the assets the trustees should have received and, according to Austin J, "An order for accounts based on wilful default has the effect of casting a much more substantial burden of proof on the accounting party than applies in the case of common accounts."[83]

To obtain an account on the basis of wilful default, the beneficiaries must plead and prove (or at least "make out a case of suspicion in the mind of the Court") that the trustees are guilty of at least one instance of wilful default.[84] This is essential because this form of account is itself a response to wrongdoing, which places the trustees at a disadvantage during the accounting process. There is no justification for ordering innocent trustees to account on that basis.

Additionally, there is no reason to order an account on the basis of wilful default if it will not uncover any other instances of wilful default. In *Re Tebbs*,[85]

[80] *Russell v Russell* (1891) 17 VLR 729, 732; *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] 1 Ch 539, 546; also see *Re Stevens* [1898] 1 Ch 162, 172 (CA).

[81] [1980] 1 Ch 539, 546; also see *Re Wrightson* [1908] 1 Ch 789, 799; *Gava v Grljusich* [1999] WASC 13, [23].

[82] *Glazier v Australian Men's Health (No 2)* [2001] NSWSC 6, [56].

[83] *Glazier (No 2)* (n 82 above) [42].

[84] *Sleight v Lawson* (1857) 3 K & J 292, 299, 69 ER 1119, 1122 (Page Wood V-C); also see *Coope v Carter* (1852) 2 De GM & G 292, 42 ER 884; *Re Symons* (1882) 21 Ch D 757; *Russell v Russell* (1891) 17 VLR 729.

[85] [1976] 2 All ER 858, [1976] 1 WLR 924.

executors admitted wilful default with respect to one land transaction. They had acted honestly and no further acts of wilful default were discovered despite "vigilant enquiries . . . made on behalf of the plaintiff" over several years.[86] Slade J noted that, "One act of wilful default having been proved, . . . the court has jurisdiction to make an order for an account on the footing of wilful default in respect of the whole estate."[87] However, he ordered only a common account with respect to the rest of the estate, because "the past conduct of the trustees" did not "give rise to a reasonable prima facie inference that other breaches of trust not yet known to the plaintiff or the court have occurred".[88]

### *(b) Equitable Compensation*

Equitable compensation for breach of trust is the payment of money directly to the beneficiaries to compensate them for the loss they have suffered as a result of the breach.[89] It is essentially similar to the payment of damages for breach of a legal duty, although (as discussed above) the method of calculating loss can be different. As Lord Browne-Wilkinson said, in *Target Holdings Ltd v Redferns*:

> Under both systems liability is fault-based: the defendant is only liable for the consequences of the legal wrong he has done to the plaintiff and to make good the damage caused by such wrong. He is not responsible for damage not caused by his wrong or to pay by way of compensation more than the loss suffered from such wrong. The detailed rules of equity as to causation and the quantification of loss differ, at least ostensibly, from those applicable at common law. But the principles underlying both systems are the same.[90]

In England and the Commonwealth, most judges and commentators take care not to refer to equitable compensation as damages, using the term "equitable damages" only to describe damages awarded under Lord Cairns Act,[91] as a substitute or supplement to specific performance or an injunction. This distinction does not exist in American law and, therefore, equitable compensation is often called damages in the United States. Bogert calls it "damages," whether obtained by way of account or direct payment:

> For a breach of trust the trustee may be directed by the court to pay damages to the beneficiary out of the trustee's own funds, either in a suit brought for that purpose or on accounting where the trustee is surcharged beyond the amount of his admitted liability.[92]

[86] *Re Tebbs* (n 85 above) 864 (Slade J).
[87] *Re Tebbs* (n 85 above) 862.
[88] *Re Tebbs* (n 85 above) 863.
[89] *Target Holdings Ltd v Redferns* [1996] 1 AC 421, 434–5.
[90] [1996] 1 AC 421, 432.
[91] Chancery Amendment Act 1858 (UK); see A Burrows *Remedies for Torts and Breach of Contract* (2nd edn Butterworths London 1994) 242–7; R Meagher, W Gummow and J Lehane *Equity Doctrines and Remedies* (3rd edn Butterworths Sydney 1992) 634–636; M Tilbury "Equitable Compensation" in P Parkinson (ed) *The Principles of Equity* (LBC Sydney 1996) 781.
[92] GG Bogert and GT Bogert *The Law of Trusts and Trustees* (rev 2nd edn West St Paul 1983) [862], 34–6.

The language used in England and Canada may be shifting. For example, in *Swindle v Harrison*, Hobhouse LJ said, "The claim which we have to consider is a claim for damages or 'equitable compensation' of the character of damages for breach of duty."[93] The term "damages" might be extended to replace "equitable compensation" or possibly even further to describe every liability to pay money arising from breach of duty, whether compensatory, restitutionary, or punitive.[94] In any event, the current practice of using different terms to describe the same form of compensation is unhelpful. Also, the current use of the term "equitable compensation" can create the mistaken impression that the account and other responses to breach of trust are not compensatory.

Equitable compensation is a subsidiary method of compensation for breach of trust. In *Canson Enterprises Ltd v Boughton & Co*, McLachlin J said that "compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate."[95] Lord Browne-Wilkinson quoted this passage in *Target Holdings Ltd v Redferns* and called it "good law."[96] If the beneficiaries cannot obtain satisfactory relief for breach of trust by taking an account or through specific restitution of trust assets (discussed below), then the payment of equitable compensation is available.

The relatively recent popularity of equitable compensation tends to obscure the fact that the account remains the main method of compelling trustees to pay compensation for breach of trust. That popularity is due primarily to the expanded application of fiduciary duties to a variety of new relationships. Where no trust assets are involved, but fiduciary duties are used to regulate the giving of advice, the account is useful only when fiduciaries are required to account for secret profits (discussed below). If their breach of fiduciary duty causes loss, compensation is available only by payment of equitable compensation directly to the claimants.

Equitable compensation is needed for breach of trust when the payment of money into the trust is no longer practical or helpful. If the breach of trust comes to light after the trust has come to an end, then, as Lord Browne-Wilkinson said, "there is no reason for compensating the breach of trust by way of an order for restitution and compensation to the trust fund as opposed to the beneficiary himself."[97] The court can order the trustees to reconstitute the fund,[98] but should only do so if the payment of equitable compensation directly to the beneficiaries is impractical or impossible. For example, reconstitution of

[93] [1997] 4 All ER 705, 722 (CA); see also *Bartlett v Barclays Bank Trust Co Ltd (No 2)* [1980] 1 Ch 539, 545; *Bristol & West Building Society v Mothew* [1998] Ch 1, 17 (CA).
[94] See H McGregor "Restitutionary Damages" in P Birks (ed) *Wrongs and Remedies in the Twenty-First Century* (Clarendon Oxford 1996) 203.
[95] (1991) 85 DLR (4th) 129, 163 (SCC).
[96] [1996] 1 AC 421, 438–9.
[97] *Target Holdings Ltd v Redferns* [1996] 1 AC 421, 434–5.
[98] *Target Holdings* (n 97 above) 435.

a trust might be needed where the trust was for a charitable purpose or for discretionary distribution among a class of beneficiaries.

In some situations, payment directly to a beneficiary might be appropriate even though the trust continues. For example, in *Re Salmon*,[99] a retired trustee was required to pay compensation directly to one of the beneficiaries for loss caused by a breach of trust that had occurred three years before he retired. The new trustees and some of the beneficiaries had released and indemnified the retired trustee from liability for breach of trust and could not sue him. The amount of compensation paid to the plaintiff beneficiary was the loss to the value of his share of the trust. The other beneficiaries, who had not released and indemnified the retired trustee, were given liberty to apply in chambers for compensation for the losses to their shares.

The amount of equitable compensation paid directly to the beneficiaries should be the same as the amount that the trustees would have paid to the trust if they had accounted for the loss while the trust was being performed. Lord Browne-Wilkinson said that, in both situations, the "measure of such compensation is the same, ie, the difference between what the beneficiary has in fact received and the amount he would have received but for the breach of trust."[100] This makes sense. The account and equitable compensation are merely different ways to compensate for the same loss caused by the same breach of duty. There is no reason why they should produce different levels of compensation.

When a breach of trust occurs, beneficiaries often have a choice between two different responses to that breach and are free to choose the most advantageous response. Normally, those responses have different goals. For example, if trustees misappropriate trust assets, the beneficiaries can choose between restitution of the trustees' gain or compensation for the loss to the trust. Sometimes, a single transaction is both a breach of trust and some other wrong, such as a breach of confidence, tort, or breach of contract. Each wrong might cause a different level of loss and, therefore, a different level of compensation, even though the response to each wrong pursued the same basic goal of compensating for loss. In such a case, the beneficiaries should be free to choose compensation for the wrong that has caused the greatest loss.

However, where there are two ways to achieve the same goal with respect to the same breach of duty, there is no reason why they should produce substantially different results. So long as equitable compensation and the account produce the same level of compensation, the beneficiaries do not need the freedom to choose between them. The court can rely on the account as the most practical method of compensating for breach of trust and relegate equitable compensation to a subsidiary role to be used only when the account is no longer practical.

[99] (1889) 42 Ch D 351, 371 (CA).
[100] *Target Holdings* (n 97 above) 435.

### *(c) Interest*

When trustees are required to pay a sum to the beneficiaries or into the trust, they are often required to pay interest on that sum. In *Re Dawson*, Street J said, "The Court's jurisdiction in selecting the appropriate rate of interest is exercisable solely for compensatory purposes."[101] However, this is incorrect. Like the account, an award of interest can be used to obtain compensation or restitution. The former is measured by the interest that trustees should have earned for the trust, while the latter is measured by the interest they earned for themselves in breach of trust.[102]

Although courts have long recognised that wrongdoing trustees should be compelled to pay interest either to repair the loss they caused the trust or to ensure that they do not gain from doing wrong, the actual awards made in many cases did not pursue those goals vigorously. There was a long standing practice of selecting either simple or compound interest at a rate of either four per cent or five per cent to best achieve the goal of either compensation or restitution. Compound interest was awarded as compensation, if the trustees had a duty to invest trusts assets at compound interest and had failed to do so.[103] It was also awarded as restitution, where the trustees misused trust assets in their own business.[104] The higher rate of five per cent was available if misappropriated trust assets had been properly invested at that rate, used by the trustees in their business, or taken in deliberate breach of trust.[105] The limited choices available meant that an award of interest was a blunt instrument that could only approximate a desired goal.[106]

Today, courts are free to choose an interest rate and method of calculation that more accurately pursues the goal for which it is being awarded. In *Bartlett v Barclays Bank Trust Co Ltd (No 2)*, Brightman LJ said:

> In former days a trustee was as a rule charged only with interest of 4 per cent. unless there were special circumstances. . . . In these days of huge and constantly changing interest rates (the movement being usually upwards so far) I think it would be unrealistic for a court of equity to abide by the modest rate of interest which was current in the stable times of our forefathers.
>
> In my judgment, a proper rate of interest to be awarded, in the absence of special circumstances, to compensate beneficiaries and trust funds for non-receipt from a trustee of money that ought to have been received is that allowed from time to time on the

101 [1966] 2 NSWR 211, 218.
102 *A-G v Alford* (1855) 4 De GM & G 843, 851, 43 ER 737, 741; also see *Wallersteiner v Moir (No 2)* [1975] QB 373, 388 (CA).
103 *Jones v Foxall* (1852) 15 Beav 388, 393, 51 ER 588, 590; *Knott v Cottee* (1852) 16 Beav 77, 51 ER 705; *Re Emmet's Estate* (1881) 17 Ch D 142; *Re Barclay* [1899] 1 Ch 674, 686.
104 *Wallersteiner v Moir (No 2)* [1975] QB 373, 397, 406 (CA).
105 *Jones v Foxall* (1852) 15 Beav 388, 51 ER 588; *Knott v Cottee* (1852) 16 Beav 77, 51 ER 705.
106 See, eg, *A-G v Alford* (1855) 4 De GM & G 843, 853, 43 ER 737, 742; *Gordon v Gonda* [1955] 2 All ER 762, 767 (CA).

courts' short-term investment account, established under section 6(1) of the Administration of Justice Act 1965.[107]

When using an award of interest as compensation, the court recognises that the trust has been deprived of the use of assets, which the trustees wrongly either disbursed or failed to receive, and asks what the trustees would have done with those assets if they had acted properly. This sort of inquiry could go beyond the limits of remoteness of damage set by the common law (which might explain the common law restrictions on awards of interest).[108] However, this is permitted when compensating for breach of trust. Also, an inquiry into the interest the trustees should have received is not the same as an account on the basis of wilful default and is not restricted to cases where that form of account is ordered.[109] The normal method of compelling trustees to pay interest is by charging it to the account (in whatever form), but it can also be added to awards of equitable compensation.

## D RESTITUTION

In this essay, "restitution" is used as a term of art describing the obligation to give up an asset or its value in money.[110] Some of the consequences of breach of trust have this goal. Where trust assets have been misappropriated, the beneficiaries can seek to recover them. They have property rights to those assets, that can be asserted against the trustees and others (subject to defences such as bona fide purchase). They can also seek to have the value of those assets paid into the trust.

Restitution is not limited to the recovery of misappropriated trust assets or their value. Trustees can also breach their trust duties by receiving assets from other sources. Normally, the trustees' duty of loyalty requires that they avoid personal interests and other duties that might conflict with the proper performance of their trust duties (unless all the trust beneficiaries have consented to the conflict). If trustees receive assets in breach of that duty, they will be required to give them (or their value) up to the trust, even though the trust suffered no loss as a result of the breach.[111]

Why is restitution a potential consequence of breach of trust, even in the absence of loss to the trust? It is an application of the general rule that people

[107] [1980] 1 Ch 539, 546–7; also see *Wallersteiner v Moir (No 2)* [1975] QB 373 (CA); D Hayton *Underhill and Hayton Law Relating to Trusts and Trustees* (15th edn Butterworths London 1995) 839–40, 842.

[108] See Law Commission *Law of Contract: Report on Interest* (Law Com No 88, 1978); *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669.

[109] *Re Barclay* [1899] 1 Ch 674, 681; but see *Re Stevens* [1898] 1 Ch 162, 172, 176 (CA).

[110] P Birks *An Introduction to the Law of Restitution* (rev edn Clarendon Oxford 1989) 13.

[111] *Boardman v Phipps* [1967] 2 AC 46.

should not profit by doing wrong.[112] Although restitution is not available for every wrong and it is not always clear when and how it is available,[113] breach of trust is regarded as a paradigm of restitution yielding wrongs. There is no doubt that trustees are required to give up any assets or other benefits acquired as a result of a breach of trust.[114]

### 1 Restitution for Wrongs vs Restitution of Unjust Enrichment

Just as restitution must be distinguished from compensation, restitution for wrongs must be distinguished from restitution of unjust enrichment. When trustees acquire assets or other benefits in breach of trust, they can be compelled to make restitution of those assets or the value received. This is restitution as a response to the wrong of breach of trust and applies regardless of whether the assets were misappropriated from the trust or acquired from other sources. However, when assets are taken from the trust, it is also possible to base the claim for restitution on unjust enrichment, rather than on the wrong of breach of trust.

The duty to make restitution of unjust enrichment is not a secondary duty arising on breach of the primary duty (to perform the trust), but a primary duty arising upon receipt of an unjust enrichment (at the expense of the trust). The receipt of assets from the trust is an unjust enrichment because it was unauthorized by the terms of the trust. Although the unauthorized disposition of trust assets is almost certainly a breach of trust, the duty to make restitution of those assets or their value, as unjust enrichment, is not dependent on the wrong. Therefore, innocent recipients of those assets (or their traceable proceeds) can be required to make restitution even though they are not parties to the breach.[115]

If the claim for restitution of unjust enrichment is available against innocent recipients of value misappropriated from a trust, it must also be available against trustees who receive that value. In most cases, the possibility of restitution of unjust enrichment will not be important because the trustees will be liable to make restitution of any assets received through the commission of a wrong. However, it is conceivable that restitution for the wrong of breach of trust could be nullified by an exemption clause, which would not affect the right to restitution of unjust enrichment. It is also conceivable that trustees could be unjustly enriched by the receipt of trust assets, without breaching the trust. For example, if a beneficiary was unduly influenced to sell trust assets to an honest

[112] *A-G v Guardian Newspapers (No 2)* [1990] 1 AC 109, 286.
[113] See *A-G v Blake* [2001] 1 AC 268.
[114] *Vyse v Foster* (1874) LR 7 HL 318, 329, 337.
[115] See, eg, *Wilson v Turner* (1883) 22 Ch D 521 (CA).

trustee for fair market value, the sale might be set aside on the basis of unjust enrichment, even in the absence of breach of trust.

## 2 Methods of Restitution

There are two main types of restitution: (1) restitution of specific assets and (2) restitution of the value of assets or other benefits. When a defendant is required to make restitution of a specific asset, he or she has a duty to give up that asset, which corresponds to the claimant's property right to it. The duty and right may be legal or equitable. For example, the rescission of a sale induced by fraud usually restores legal title to the claimant, while the right to rescind a transaction entered under undue influence is only equitable. Restitution of specific assets acquired in breach of trust is always equitable, usually by means of a trust of those assets or by rescission of the transaction through which those assets were acquired.

A defendant's duty to make restitution of the value of an asset or other benefit corresponds to the claimant's personal right to be paid a sum equal to that value. That duty might be secured by a lien over one or more of the defendant's assets (as discussed below). A personal right to restitution of value may be legal or equitable. As a response to breach of trust, that right is equitable. The account is the mechanism normally used to ascertain the value to be paid and create the duty to pay.

### *(a) Account*

There is no doubt that trustees are accountable for any profits they receive in breach of trust.[116] The account of profits is the best known form of account, because it is used in a wide variety of situations to obtain restitution of profits earned in breach of duty, such as breach of confidence, breach of a director's fiduciary duty to the corporation, or interference with intellectual property rights. Trustees can be compelled to account for profits earned by misusing trust assets[117] or from other activities that conflict with the trustees' duty of loyal service to the trust.[118]

Whenever trustees receive assets in breach of trust, those assets are also held in trust (as discussed below). The account of profits can be used as a supplement or alternative to that trust. If the profits have been spent, leaving no traceable proceeds, a trust is not possible (due to the absence of subject matter) and restitution will be effected through an account of profits or award of interest (discussed below). Also, trustees might wrongly receive benefits that cannot be the subject of a trust. For example, if pension trustees were given vacations to

[116] *Vyse v Foster* (1874) LR 7 HL 318, 329, 337.
[117] A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [208.1].
[118] Eg, *Boardman v Phipps* [1967] 2 AC 46; see Scott (n 117 above) [203].

induce them to invest pension funds in particular assets, they would have to account for the value of those vacations.

An account of profits serves two functions. First, it compels trustees to provide information to the beneficiaries. As discussed above, the trustees have a primary duty to account for their management of trust assets and also have a secondary duty to provide information about activities that conflict with their duty of loyal service to the trust. The information provided in the account of profits can help beneficiaries assert their trust rights to misappropriated assets, the traceable proceeds of those assets, and the profits earned with those assets or proceeds. It also helps them calculate the value of profits earned by the trustees in breach of trust (and then choose whether to claim those profits or compensation for loss). Secondly, an account of profits can be combined with an order to pay the value of those profits, thus compelling the trustees to make restitution of that value.

The calculation of the value of profits earned in breach of trust can be very difficult, especially where the breach consists of the trustees' misuse of trust assets to carry on business over many years. Trustees are not required to give up all their profits, but only those derived from the breach. Anything more would be forfeiture and therefore punishment, rather than restitution. Where trustees have misused trust assets in their own business, it is necessary to ascertain how much of their profit was derived from the use of those assets and how much was derived from other sources, such as their skill, effort, goodwill, and opportunities.[119] If this calculation is very difficult, it may be preferable to require instead repayment of the sum misappropriated, together with interest at a rate set to effect restitution of the value the trustees derived from their misuse of the fund.[120] Alternatively, where the entire business activity was undertaken in breach of trust, the court can compel the trustees to give up all their profits, less an allowance for their effort and skill.[121]

When beneficiaries discover that their trustees may be carrying on business in breach of trust, they are expected to claim an account (or trust) of those profits without delay. Courts look unfavourably upon beneficiaries who stand by, risking nothing and waiting to see if the trustees' business succeeds before claiming a share of the profits. If there is a long, unexplained delay between the beneficiaries' discovery of the breach and their claim for the profits, the court may dismiss that claim.[122]

### *(b) Trust*

When trustees acquire assets in breach of trust, there is no doubt that they will hold those assets in trust as well. There are two main ways in which this can

119 *Vyse v Foster* (1872) 8 Ch App 309, 331–2.
120 See *Vyse v Foster* (1872) 8 Ch App 309, 333–4, 337.
121 *Boardman v Phipps* [1967] 2 AC 46.
122 *Re Jarvis* [1958] 2 All ER 336, 341–2.

happen. First, trustees might misuse trust assets to acquire other assets. Secondly, trustees might, without misusing trust assets, acquire assets for themselves in a manner that places their personal interests (or other duties) in conflict with their duty of loyal service to the trust.

(i) Misuse of Trust Assets If the trustees make an unauthorized investment (whether purporting to act for the trust or misappropriating trust assets for their own benefit), the investment will be held in trust. The beneficiaries can either reject or adopt the investment. If rejected, the investment is deleted from the account and the trustees are liable to compensate the trust for the loss, with interest. If adopted, the investment and the profits earned thereby are included in the account and belong to the trust.

The beneficiaries' property rights to an improper investment arise when the investment is made and not later when the investment is adopted. As Lord Millett said in *Foskett v McKeown*:

> A beneficiary of a trust is entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds also, and his interest binds every one who takes the property or its traceable proceeds except a bona fide purchaser for value without notice.[123]

An improper investment of trust assets is the traceable proceeds of those assets and will be held in trust as soon as it is acquired. By adopting the investment, the beneficiaries are merely asserting their beneficial ownership of those proceeds. If the beneficiaries reject the investment, it will cease to be held in trust, but the beneficiaries will then have a lien over the investment to secure the trustees' obligation to pay compensation for loss.[124]

(ii) Conflict of Interest Trustees may breach their trust by engaging in activities that conflict with their duty of loyal service to the trust. If they acquire assets in breach of this duty of loyalty, those assets will be held in trust even though that acquisition did not involve the misuse of any other trust assets. For example, if trustees are unable to make a particular investment on behalf of the trust or honestly decide that it should not be made, they are not then permitted to take that investment for themselves.[125] Otherwise, trustees might fail to use their best efforts to obtain profitable investments for the trust if they knew that investments not purchased for the trust were available for their own benefit.[126] When assets are acquired in breach of the duty of loyalty, they are held in trust from the moment of receipt.[127]

[123] [2001] 1 AC 102, 127.
[124] *Foskett v McKeown* [2001] 1 AC 102, 130.
[125] *Keech v Sandford* (1726) Sel Cas T King 61, 25 ER 223; *Boardman v Phipps* [1967] 2 AC 46.
[126] See S Gardner *An Introduction to the Law of Trusts* (Clarendon Press Oxford 1990) 176–7.
[127] See *A-G Hong Kong v Reid* [1994] 1 AC 324, 331, [1994] 1 NZLR 1 (PC).

(iii) Classification of the Trust How should a trust arising in response to breach of trust be classified? There is no doubt that a "conflict of interest trust" (as opposed to a "misuse of assets trust") is constructive, arising only because the trustees acquired an asset through the commission of a wrong.[128] However, the classification of a "misuse of assets trust" is controversial. Lord Browne-Wilkinson called it an express trust in *Foskett v McKeown*,[129] but there are good arguments for calling it either constructive or resulting.

Why does the label matter? It does not alter the nature of the beneficiaries' property rights to the improperly acquired assets nor does it affect the nature of the trustees' duties with respect to those assets. Although the standard duties of express trustees often do not apply to constructive or resulting trustees,[130] that issue is not relevant here. If the improper investment is adopted, it will simply be added to the existing trust, subject to the same rights and duties as the original trust assets.

The label matters, not because it changes the nature of the trust, but because it explains the origin of the trust. Our traditional classification of trusts, as express, resulting, or constructive, is based on the events which bring those trusts into being. It is accepted that express trusts are created by the intention of a settlor and, although the origins of resulting and constructive trusts remain controversial, there are strong arguments that resulting trusts are created by unjust enrichment, while constructive trusts are created by wrongdoing, intentions to benefit others, and other events.[131]

When we ask whether it is right to call the "misuse of assets trust" an express trust, what we really want to know is whether it is created by intention or arises by operation of law in response to some other event. If the new asset had been acquired properly, it is clear that it would have been held under the original express trust, having been acquired under the authority given to the trustees by the settlor. This cannot be said of assets wrongly acquired without that authority.

A possible justification for calling it an express trust is that it depends upon adoption by the beneficiaries. Unless all the beneficiaries ratify its acquisition, the disbursement is deleted from the account and the trustees are required to pay compensation for loss.[132] Since all the beneficiaries can together agree to terminate or modify the trust, according to the rule in *Saunders v Vautier*,[133] their adoption of the improper investment is, in essence, an ad hoc variation of

[128] See *Soulos v Korkontzilas* [1997] 2 SCR 217, 146 DLR (4th) 214, 227; R Chambers "Constructive Trusts in Canada" (1999) 37 Alberta L Rev 173, 175–82.
[129] [2001] 1 AC 102, 108.
[130] See R Chambers *Resulting Trusts* (Clarendon Oxford 1997) 194–200.
[131] See P Millett "Restitution and Constructive Trusts" (1998) 114 L Q Rev 399; R Chambers "Resulting Trusts in Canada" (2000) 38 Alberta L Rev 378.
[132] *Wright v Morgan* [1926] AC 788, 798 (PC); A Scott and W Fratcher *The Law of Trusts* (4th edn Little, Brown & Co Boston 1988) [214.1].
[133] (1841) Cr & Ph 240, 41 ER 482.

the trustees' authority after the fact. One difficulty with this analysis is that the trust of an improper investment arises as soon as it is acquired, even though the beneficiaries have not adopted it and are probably unaware of it.

Another difficulty with this analysis is that it does not explain how the trust attaches to assets acquired by innocent donees with the traceable proceeds of value misappropriated from the trust. Suppose, for example, that trustees wrongly give trust assets to their sister and that she is entirely innocent and unaware of the breach of trust. There is no doubt that those assets will still be subject to the trust, because she is not a bona fide purchaser for value. If she then uses those assets to buy another asset, the trust will attach to the new asset as the traceable proceeds of the original trust assets. No one intended to create a trust of the new asset nor did the sister act wrongly when she acquired it. The trust of the new asset can be explained as restitution of unjust enrichment, but this did not find favour with Lord Browne-Wilkinson or Lord Millett in *Foskett v McKeown*.[134] Nevertheless, the new asset was acquired at the expense of the beneficiaries without their consent and the trust will effect restitution of that value to them.

Yet another difficulty relates to formalities. Suppose that trustees held chattels under an oral express trust and misused those assets to buy land for themselves. There is no doubt that the land would be held in trust but, in the absence of writing, it would not be a valid express trust. Although this problem will seldom arise, it does illustrate the need to find a better explanation of the origin of the "misuse of assets trust."

When trustees misuse trust assets to acquire other assets for themselves, there are at least two explanations for the trust of the wrongly acquired assets. First, the trustees are guilty of breach of trust and a constructive trust arises to ensure that they do no benefit from their own wrongdoing. This is Professor Scott's view.[135] Secondly, the trustees have unjustly enriched themselves at the expense of the trust and a resulting (or constructive) trust arises to effect restitution of that unjust enrichment.[136]

Even if the "misuse of assets trust" can be explained as an express trust created by intention, the possibility of an alternative analysis should not be overlooked. If, for whatever reason, the necessary intention cannot be found, then a constructive trust based on wrongdoing could arise. In the absence of intention and wrongdoing, unjust enrichment provides a suitable justification for the trust.

### *(c) Lien*

If trustees invest trust assets improperly, the beneficiaries can claim either a trust of or a lien over that investment. As Lord Millett said in *Foskett v McKeown*:

[134] [2001] 1 AC 102, 108, 127.
[135] Scott (n 132 above) [202], [508].
[136] *Ryall v Ryall* (1739) 1 Atk 59, 26 ER 39; Chambers (n 130 above) 21–3.

> [T]he beneficiary is entitled *at his option* either to assert his beneficial ownership of the proceeds or to bring a personal claim against the trustee for breach of trust and enforce an equitable lien or charge on the proceeds to secure restoration of the trust fund. . . . Where a trustee wrongfully uses trust money to provide part of the cost of acquiring an asset, the beneficiary is entitled *at his option* either to claim a proportionate share of the asset or to enforce a lien upon it to secure his personal claim against the trustee for the amount of the misapplied money.[137]

The trust is restitutionary, causing the trustees to give up the improper investment, but the lien is not. The lien arises when the beneficiaries reject the improper investment and secure the trustees' obligation to pay compensation for the loss to the trust. There is some confusion over this, because the lien appears to be restitutionary. There are two main reasons for this confusion: first, as discussed above, courts often use the word "restitution" to mean compensation for breach of trust and, secondly, the lien attaches to the traceable proceeds of trust assets. These two factors can create a mistaken impression that the lien secures an obligation to make restitution or that its effect is the restitution of value wrongly taken from the trust.

Although a lien is a property right to a specific asset, it differs significantly from property rights created to effect restitution of specific assets. The lien does not give the beneficiaries the right to take the asset from the trustees, unless the trustees fail to pay the debt secured by the lien. The trustees are the beneficial owners of the asset, subject to the beneficiaries' security interest, and, on payment in full, the beneficiaries' interest in the asset ceases to exist. Being only a limited property right, a lien does not turn a right to the payment of money into a right to restitution of a specific asset. The trustees' duty (secured by the lien) is to pay a sum of money and not to give any specific asset to the beneficiaries.

As a security interest, the main purpose of the lien is to make it more likely that a debt will be paid. If the debt is paid, the lien has served its purpose and, therefore, the ultimate goal of the lien is the goal pursued by the debt. For example, a vendor's lien secures direct performance of a primary duty to pay the purchase price, while a lien for improvements secures the duty to make restitution of the value of those improvements. The trustees' duty to pay for the value of assets wrongly disbursed is compensation. It is created and measured by the loss to the trust, without regard for the benefit the trustees may have derived from that disbursement. The lien facilitates achievement of this compensatory goal.

Since a lien can arise to secure a duty to make restitution, can it be used to secure the trustees' duty to pay the sum due on an account of profits? A lien is unnecessary in that situation, because the only assets to which the lien might attach will be held in trust. If the beneficiaries adopt the improper investment, the account will show that investment as a receipt (offsetting the improper disbursement). Any additional profits, that do not survive as assets capable of being subject to a trust (or lien) can also be charged to the account as receipts.

137 [2001] 1 AC 102, 130, 131.

In this way, the trustees will be accountable for all profits earned in breach of trust, either as assets held in trust or as sums due to the trust.

Although a lien on profits is unnecessary, should beneficiaries be permitted to abandon their beneficial ownership of those profits in favour of a lien? Probably not. By choosing restitution instead of compensation, the beneficiaries have elected to take the investment from the trustees and should bear the risk of loss as well as the chance of gain. In *Heathcote v Hulme*,[138] trust assets had been improperly invested and the beneficiaries wanted the profits of that investment up to a certain date and then interest paid on it thereafter. They were required to choose one or the other. Plumer MR said:

> The novelty of the demand alone is against it. But, besides this, it would be contrary to justice; for what is the principle of the option that is given? It is, that the party elects, whether he will ratify the employment of his capital; whether he will say that it was properly applied to trade; if so, he may take the profit, but he must also be subject to the loss.[139]

If justice requires that beneficiaries bear the risk of loss along with hope of gain from adopted investments, then beneficial ownership under a trust is the appropriate method of restitution.

### *(d) Rescission*

Rescission is another possible response to an improper disposition of trust assets. If they are transferred to a donee or to someone who has notice of the impropriety, the transaction can be rescinded, thereby restoring title to the trustees. All improper transfers of assets from the trustees to one of their number are subject to rescission. As Millett LJ said, in *Armitage v Nurse*, "the purchasing trustee could never obtain more than a defeasible title from such a transaction."[140]

There are two important differences between rescission and the "misuse of assets trust" discussed above: (1) the proprietary effect of each response and (2) the grounds on which they are available. First, as discussed above, the trust attaches to the traceable proceeds of misused trust assets as soon as the improper disposition occurs. In most cases, those proceeds are purchased from an innocent seller and, therefore, the trust of the original assets is defeated by the defence of bona fide purchase. In contrast, rescission operates to undo the improper disposition. The beneficiaries have an equitable property right to the recoverable trust assets, but not full beneficial ownership. The transfer is not void, but voidable and they have only a lesser equitable property right (which can be defeated by an innocent buyer of a competing equitable interest) until the right to rescind is exercised.[141]

138 (1819) 1 Jac & W 122, 37 ER 322.
139 (1819) 1 Jac & W 122, 132, 37 ER 322, 325–6.
140 [1998] Ch 241, 253 (CA).
141 See P Millett "Restitution and Constructive Trusts" (1998) 114 L Q Rev 399; R Chambers *An Introduction to Property Law in Australia* (LBC Sydney 2001) 323–4, 419–23.

Secondly, rescission is available even though the trustees are not guilty of breach of trust or are fully exempt from liability for the breach.[142] It is available where a beneficiary's consent to the transaction was induced by mistake or undue influence and does not depend on proof of loss to the trust or wrongful gain by the trustee. As Millett LJ said, the "claim would succeed even if the sale was at an overvalue".[143] In most cases, the ground for rescission will also be a breach of trust. However, the fact that liability for breach is not required shows that rescission is not (or is not restricted to) restitution for wrongs, but operates as restitution of unjust enrichment in the absence of wrongdoing.

### *(e) Interest*

In *A-G v Alford*, Lord Cranworth LC identified three permitted bases for charging trustees with interest:

> What the Court ought to do, I think, is to charge him only with the interest which he received, or which it is justly entitled to say he ought to have received, or which it is so fairly to be presumed that he did receive that he is estopped from saying that he did not receive it.[144]

The first option, the interest the trustees did in fact receive, is simply restitution through an account of profits. The second option, the interest the trustees should have received, is compensation for loss (as discussed above). The third option, the interest the trustees are presumed to have received, is also restitution, but through an award of interest rather than an account of profits.

Beneficiaries often have an option to take an account of profits or an award of interest. In most cases, this is a choice between restitution of profits or compensation for loss. However, the choice can also be between two methods of restitution: an account of interest actually earned or a surcharge for interest that the trustees presumably earned. An award of presumed interest will be chosen to avoid the expense or delay of taking an account of actual earnings and may be necessary where the actual earnings cannot be ascertained. As James LJ said in *Vyse v Foster*:

> If an executor or trustee makes profit by an improper dealing with the assets or the trust fund, that profit he must give up to the trust. If that improper dealing consists in embarking or investing the trust money in business, he must account for the profits made by him by such employment in such business; or at the option of the *cestui que trust*, or if it does not appear, or cannot be made to appear, what profits are attributable to such employment, he must account for trade interest, that is to say, interest at 5 per cent.[145]

An award of interest to effect restitution is a relatively rough way to achieve that goal. As long as the presumption of profit is fairly made, the goal is

[142] *Armitage v Nurse* [1998] Ch 241, 252–3 (CA).
[143] *Armitage v Nurse* [1998] Ch 241, 253 (CA).
[144] (1855) 4 De GM & G 843, 851, 43 ER 737, 741.
[145] (1872) 8 Ch App 309, 329.

restitution and not punishment (as discussed below). As with compensatory interest (discussed above), restitutionary interest was a blunt instrument when choices of interest rates were limited to four or five per cent. However, courts are no longer bound by those limits. In *Wallersteiner v Moir (No 2)*, there had been no investigation into the profits earned by a director in breach of his fiduciary duty to his corporation and the court awarded compound "interest at 1 per cent. per annum above the official bank rate or minimum lending rate in operation from time to time" to effect restitution of the profit he was presumed to have made.[146]

## E PUNISHMENT

The three goals discussed above (direct enforcement, compensation, and restitution) are defined by logical limits (respectively, the primary duties existing before the breach, the loss caused by the breach, or the gain derived from the breach). All the liabilities that pursue these goals are confined by the goal pursued. In contrast, the liabilities designed to punish wrongdoers are not confined by that goal in the same way. Although the only punishment used in modern private law is the payment of money, that goal does not dictate the sum to be paid and, in theory, any adverse consequence could be used for that purpose.

Punishment is rarely encountered in the private law of England and Wales, where punitive damages are used only sparingly as a response to torts and not at all for breach of contract.[147] Punitive damages are available for breach of fiduciary duty in Canada[148] and in many of the United States,[149] but in other jurisdictions it is generally accepted that punishment is not a possible consequence of a breach of equitable duty.[150] As James LJ said in *Vyse v Foster*:

> This Court is not a Court of penal jurisdiction. It compels restitution of property unconscientiously withheld; it gives full compensation for any loss or damage through failure of some equitable duty; but it has no power of punishing any one.[151]

Although most courts of equity do not punish defaulting trustees, punishment can be relevant to breach of trust in two ways. First, a breach of trust

[146] [1975] QB 373, 399 (Buckley LJ).
[147] A Burrows *Remedies for Torts and Breach of Contract* (2nd edn Butterworths London 1994) 270–85.
[148] *Huff v Price* (1990) 76 DLR (4th) 138 (BC CA).
[149] GG Bogert and GT Bogert *The Law of Trusts and Trustees* (rev 2nd edn West St Paul 1983) [862], 50–7.
[150] R Meagher, W Gummow and J Lehane *Equity Doctrines and Remedies* (3rd edn Butterworths Sydney 1992) 638; *Packard v Provident National Bank* 994 F2d 1039 (3rd cir 1993); but see M Tilbury "Equitable Compensation" in P Parkinson (ed) *The Principles of Equity* (LBC Sydney 1996) 781, 789–90.
[151] (1872) 8 Ch App 309, 333.

might also be a crime (such as forgery, fraud, or theft) or other offence and attract a punishment imposed by public law.[152] Secondly (and more importantly for this essay), in those jurisdictions where the law of trusts openly refuses to punish, care must be taken to ensure that liabilities for breach of trust are not hidden punishments. The goals of secondary duties arising upon a breach of trust should be checked. Do they effect compensation or restitution and, if not, do they pursue a legitimate goal other than punishment?

With relatively few cases of punishment in private law and no logical limits set by that goal, it may be difficult to tell whether responses to breach of duty (other than direct enforcement, compensation, and restitution) are punishments or in pursuit of some other goal. A comparison with criminal law principles may be helpful. The punishment of crime deters and denounces socially unacceptable behaviour. It is generally accepted that punishments should be proportionate to the severity of the offence, which depends primarily upon the moral fault of the offender and the harm caused by the offence.[153] Although the principles governing punishment in private law are not nearly so well developed (which is a reason for abolishing it),[154] one might expect that it should be guided by the same principle of proportionality. In other words, punishments for breaches of private law duties should vary according to the severity of the breach, assessed according to its consequences and the culpability of the wrongdoer.[155]

Of course, responses to breach of duty are not punishments just because they relate to the consequences of the breach or the moral culpability of the wrongdoer. All responses to breach of duty depend on, or at least may be affected by, its consequences (such as whether the breach caused loss, produced a gain, or made future performance of a primary duty impossible). Responses to breach can also be affected by the wrongdoer's culpability. For example, liability for assisting a breach of trust depends on dishonesty and, for some wrongs, restitution is available only if the wrong is committed intentionally. Although a liability to pay compensation or make restitution may be triggered by a certain level of moral culpability, the liability itself is not proportional to the degree of culpability, but equal to the loss or gain caused by the breach. If a liability to pay does vary with the wrongdoer's culpability, it is not compensation or restitution, but looks suspiciously like punishment.

The risk of concealed punishment is increased by uncertainty in the law or its application. If responses to breach of duty are not carefully controlled by the

[152] Eg, *R v Clowes (No 2)* [1994] 2 All ER 316 (CA); see S Gardner *An Introduction to the Law of Trusts* (Clarendon Oxford 1990) 181–3; D Hayton *Underhill and Hayton Law Relating to Trusts and Trustees* (15th edn Butterworths London 1995) 875–80; Bogert (n 149 above) [861], 24.

[153] J Smith *Smith & Hogan Criminal Law* (9th edn Butterworths London 1999) 4–5; A Ashworth *Principles of Criminal Law* (3rd edn OUP Oxford 1999) 18–21, 37–42.

[154] A Burrows *Remedies for Torts and Breach of Contract* (2nd edn Butterworths London 1994) 282–5.

[155] *Huff v Price* (1990) 76 DLR (4th) 138, 154–5 (BC CA).

goals they purport to achieve, the discretion to vary those responses might be affected by the moral culpability of the wrongdoer. At least two aspects of the law of trusts have been used in this way: (1) awards of interest and (2) presumptions against wrongdoers.

### 1 Interest

As discussed above, trustees can be compelled to pay interest as compensation for loss or restitution for gain. In *A-G v Alford*, Lord Cranworth LC said that these are the only justifications for awarding interest:

> I do not think there is any other intelligible ground for charging an executor with more interest than he has made, than one of those I have mentioned. Misconduct does not seem to me to warrant the conclusion, that the executor did in point of fact receive, or is estopped from saying that he did not receive, the interest, or that he is to be charged with anything he did not receive, if it is not misconduct contributing to that particular result.[156]

In *Burdick v Garrick*,[157] the court confirmed that interest should not be awarded as punishment. Nevertheless, courts have set interest rates with reference to the moral quality of the trustees' conduct rather than as a true measure of loss or gain. For example, in *Re Dawson*, Street J said that "the Court does not, in ordering interest and in selecting a rate, attempt in any way to impose a punishment upon the defaulter."[158] Despite this affirmation of principle, he went on to choose a higher rate of interest precisely because the breach of trust "was a deliberate and wilful act the purpose of which was to deprive the estate of the moneys in question."[159]

There were two difficulties which led to the misuse of interest as a form of punishment. First, awards of interest involved a large measure of discretion, leaving courts with little guidance and the freedom to use them as penalties.[160] Secondly, with limited choices available, awards of interest could not achieve their permitted goals of compensation and restitution with precision. Unable to hit the mark, a court's decision to aim high or low might be determined by the moral quality of the trustees' breach. These problems have been alleviated by clear statements of the principle that interest should be used not to punish, but only for compensation or restitution, and by the freedom to set interest rates that can accurately achieve those goals.

[156] (1855) 4 De GM & G 843, 851–2, 43 ER 737, 741.
[157] (1870) LR 5 Ch App 233.
[158] [1966] 2 NSWR 211, 218.
[159] *Re Dawson* [1966] 2 NSWR 211, 218 (Street J).
[160] *Jones v Foxall* (1852) 15 Beav 388, 393, 51 ER 588, 590.

### 2 Presumptions

Normally, claimants bear the onus of proving all the facts essential to their claims. However, there are certain well known presumptions (such as the presumption of resulting trust or presumption of undue influence) that can be used to shift the onus of proof to defendants. One of these is the presumption against wrongdoers. If defendants make proof of an essential fact impossible, by wrongly destroying evidence of committing some other breach of duty, the court will make a presumption of that fact adversely to them.[161] They then bear the onus of disproving the presumed fact.

The presumption against wrongdoers is familiar in the law of trusts. If trustees wrongly mix trust assets with their own, making it impossible to determine the fate of the trust assets, the court will resolve that uncertainty adversely to the trustees. It will presume that the assets that survived and prospered belonged to the trust, while the assets that were lost and diminished belonged to the trustees, unless the trustees can prove otherwise.[162]

There is an important and inherent limit on the presumption against wrongdoers: it cannot be used to presume a fact in the face of proof to the contrary.[163] For example, in *Lofts v MacDonald*,[164] trustees deposited $1,600 of trust funds in a bank account. The balance of the account was then reduced to $8.42 and later increased to $2,824.50. It was impossible to presume that more than $8.42 of the trust funds had survived in the account.

If presumptions are used when contradicted by proven facts, then responses to breach of trust can become punishments. This will happen if trustees are required to compensate for loss or make restitution of gain and the court uses a presumption to set the value of loss or gain artificially high. Although the response purports to be compensation or restitution, the beneficiaries are overcompensated or the trustees have to give up more than their gain. The extra payment is a hidden punishment.

One example of a misused presumption is offered. In *Jaffray v Marshall*,[165] the trustees wrongly allowed a beneficiary to mortgage a house that belonged to the trust. The house was lost when the mortgage was enforced and the trustees were required to pay compensation for the loss. Property values had risen and fallen since the breach and the loss was set at the highest intermediate value. The court presumed that the house would have been sold when the market was at its peak even though all parties agreed that the house would not have been sold or, if sold, would have been replaced immediately by another house equally affected by the slump in the market.

[161] *Armory v Delamirie* (1722) 1 Str 506, 93 ER 664; *Lupton v White* (1808) 15 Ves 432, 33 ER 817; L Smith *The Law of Tracing* (Clarendon Oxford 1997) 77–80, 195.

[162] *Re Hallett's Estate* (1879) 13 Ch D 696 (CA); *Re Oatway* [1903] 2 Ch 356.

[163] L Smith (n 161 above) 80–5.

[164] (1974) 3 ALR 404.

[165] [1994] 1 All ER 143; disapproved in *Target Holdings Ltd v Redferns* [1996] 1 AC 421, 440.

## F OTHER GOALS

In jurisdictions where courts of equity do not punish, all responses to breach of trust, that do not enforce primary duties, compensate for loss, or effect restitution of gain, belong here in the miscellany of responses that pursue other goals. It can be difficult to identify the goals pursued by these responses, which are here only because we know that they do not pursue one of the goals discussed above. Some are not specific to the law of trusts, but are more widely available as potential responses to breach of duty in private law (such as an award of costs or appointment of a receiver). Others are known primarily for their roles within the law of trusts (such as the exoneration or replacement of trustees).

Some of the responses to breach of trust occur also in the absence of breach. For example, the court can replace trustees who breach their duties, but can do so for other reasons (such as a trustee's incapacity). Another example is an award of costs. A trustee in breach of duty may become liable to pay the claimant's legal costs. This is a consequence of the breach in the sense that the breach led to the litigation in which the costs were awarded. However, it is not a direct or necessary consequence of the breach of duty. Wrongdoers can avoid that liability by settling their disputes or making reasonable offers to settle them. Innocent parties can be required to pay costs if they proceed with litigation after rejecting a reasonable offer of settlement or fail to prove their claims.

If a potential response to breach of duty can also arise in the absence of breach, then it might be pursuing goals unrelated to the breach. Awards of costs do this. There is no doubt that a liability to pay costs is a potential consequence of breach of duty, because the breach may lead to litigation which may lead to a liability to pay the claimant's legal costs. However, awards of costs are not designed to deter wrongdoing nor do they provide substitutes for the proper performance of the duties breached. Instead, they are used to help control litigation by encouraging settlements, discouraging unworthy claims and defences, and helping worthy claimants enforce their rights.

The replacement of trustees is a consequence of a different sort. Courts will replace trustees when necessary, even in the absence of breach.[166] When used as a response to breach of trust, the replacement of trustees is designed to prevent future breaches. Decisions to replace trustees in breach are based on the likelihood that they will breach their trusts in the future.[167] In this context, the goal of replacement is linked directly to the breach.

The goal of replacing trustees in breach is the proper performance of the trust. Although replacement is not a form of direct enforcement (since it is not one of the trustee's primary duties), it is used to increase the likelihood that the primary trust duties will be performed. On the other hand, replacement of trustees is not a form of substitute performance (since the new trustees will

[166] See *Re Harrison's Settlement Trusts* [1965] 1 WLR 1492.
[167] *Re Wrightson* [1908] 1 Ch 789, 803; *Gava v Grljusich* [1999] WASC 13, [15].

carry out the original trust). However, in one sense, the purpose of replacing a trustee (which is proper performance of the trust by another person) is similar to the purpose of paying damages for breach of contract (which enables the claimant to make a new contract and thereby obtain the expected benefits of the broken contract from another person).

The replacement of trustees illustrates the problem of identifying (or at least of labelling) the goals of the miscellaneous consequences of breach of trust. It is neither direct enforcement of a primary duty nor substitute performance, but something in between needed because of the nature of the trust relationship. It serves two purposes: first, the removal of actual or potential impediments to the proper performance of the trust and, secondly, the preservation of trust assets from loss through misuse.[168] These might be regarded as the two most important "other goals."

The preservation of trust assets is also pursued by injunction, appointment of a receiver,[169] or administration of the trust by the court.[170] This is similar to, but not the same as, the enforcement of primary duties and may even interfere with the performance of those duties temporarily. However, the preservation of trust assets will make it more likely that the primary trust duties will be performed in the future.

The goals of other responses to breach of trust can be elusive. Although it is not always possible to identify or explain fully the "other goals" pursued by responses to breach of trust, the category is crucial. A proper understanding of this area of law depends on our ability to identify the goal or goals that each consequence is designed to achieve. Although most will fall in one of the three main categories (direct enforcement, compensation, or restitution), some do not. There is a temptation to force the misfits into a recognised category, by using fictions or presumptions, but it must be resisted. Organising the law is not like repairing a machine. Having bits left over is not a failure. On the contrary, the clear and accurate identification of goals not being pursued by a particular legal consequence of breach of trust can be counted as success.

## G CONCLUSION

Here ends a small essay on a big topic. Much more could be said about all the responses to breach of trust, but especially those that pursue "other goals." This essay is merely another step (hopefully) towards ending the isolation of the law of trusts from other branches of private law.

The desegregation of trust law is important for two main reasons. First, trust law needs to take advantage of modern developments in other areas of private

[168] *Letterstedt v Broers* (1884) 9 App Cas 371, 385–6 (PC).
[169] *Swale v Swale* (1856) 22 Beav 584, 52 ER 1233; D Hayton *Underhill and Hayton Law Relating to Trusts and Trustees* (15th edn Butterworths London 1995) 873.
[170] *McLean v Burns Philp Trustee Co Pty Ltd* (1985) 2 NSWLR 623, 633–6.

law. Those developments threaten to pass trusts by unless the language and methods of trust law are made accessible to lawyers in other fields. Common bases for comparisons need to be established. We must not let differences in terminology and procedure insulate the law of trusts from advances being made elsewhere.

Secondly, fiduciary duties, developed by analogy to the trust, are now being applied to a wide variety of relationships that have little in common with the traditional trustee-beneficiary relationship. We should not assume that all trustees and fiduciaries owe the same duties of care or loyalty or that they are liable in the same way when those duties are breached. Responses to breach of trust were developed to facilitate the continuing and proper management of trust assets. They may well be inappropriate when applied to fiduciary relationships where there are no assets to be managed nor any need to keep a relationship going. Unless liability for breach of trust is well understood, there is a real danger that it will be misused in other settings.

Ending the isolation of trusts will not cause substantial differences between trust law and other areas of private law to be abandoned. Liability for breach of trust does not need to be reformed, just more widely understood. The goals of the responses to breach of trust must be clearly identified and explained, using a language common to all private lawyers. Only then can we overcome superficial differences left over from a long abandoned jurisdictional divide (that never existed in many parts of the common law world).

Within the law of trusts, care must be taken to identify accurately the goals of each response to breach of trust and ensure that those responses are applied consistently with the goals they pursue. Deserving of attention is the distinction between the direct enforcement of primary duties and the secondary duties to pay compensation or make restitution following the breach of a primary trust duty. This distinction affects two areas in particular: accounts and restitution. In the law of trusts, we are familiar with the trustees' primary duty to account and their secondary duty to make restitution for breach of trust. We must not forget that trustees can also have a secondary duty to account (as compensation or restitution) and a primary duty to make restitution of unjust enrichment.

# 2

# *Duty of Care*

JOSHUA GETZLER

## A INTRODUCTION

THE MODERN LAW describing the trustee's duty of care derives from the great case of *Speight v Gaunt* (1883).[1] There Jessel MR laid down that trustees are to be held to the standard that an ordinary prudent man would follow in running his own business. Jessel MR and the other appellate judges in that case gave few authorities for this doctrine; they were making a restatement of the law, in the sense of a codifying declaration of what the law is and ought to be, with contrary arguments and authorities repressed.

Let us peer behind the curtain drawn by *Speight v Gaunt*. The duty of care of trustees before 1883 was based on an eclectic range of legal sources, including rules of bailment, admiralty, nuisance and the nascent law of general negligence, with Civilian doctrines of fault always hovering in the background. We also ought to note the social context of the classical equitable duty of care. The equitable benchmark of "ordinary prudence" emerged from eighteenth- and nineteenth-century litigations involving amateur, unremunerated trustees, such as family and friends; or unspecialized agents such as solicitors on general retainer. Trust funds typically were lost through incompetent investment, or entrustment of assets to unfaithful or insolvent delegates. In the twentieth century, by contrast, the courts were called upon to apply the prudent man standard to professional asset managers, investing funds in large-scale capital markets. To this was added the difficulty of integrating *ad hoc* legislative interventions providing changed default rules for particular aspects of trustees' powers, duties and liabilities, notably receipt, payment and delegation.

The trustee's duty of care continues to evolve today as the doctrinal fusion of law and equity accelerates. The English courts, led prominently by Lord Millett, have held that the trustee's duty of care lies outside the exclusive jurisdiction of equity. This means that a trustee's negligence will be sanctioned using the procedural, evidential, and remedial rules applied to general law obligations of tort and contract, with common rules for limitation, causation and proof of loss,

[1] *Re Speight; Speight v Gaunt* (1883) 22 Ch D 727 (CA); (1883) 9 App Cas 1 (HL).

remoteness and proximity, contributory negligence and apportionment; and not by the special rules appropriate to pure fiduciary obligations of loyalty and good faith.[2] It may be that courts historically were unwilling to expose negligent trustees to the full gamut of equitable procedures and remedies, and therefore kept the standard of the trustees' duty of care at a low level, in order to protect trustees from too great and oppressive a liability.

The recent judicial trend to assimilate the equitable duty of care into the common law of negligence strips away any possible procedural advantages of equitable suit, but at the same time it clarifies and heightens the content and standard of that duty by requiring the trustee to take objectively reasonable care in the context of the particular trusteeship, including due professional care where appropriate. More clarity in this area has come with the Law Commission's review of trustees' powers and duties, culminating in the Trustee Act 2000. This statute supplies a firmly objective standard for performance of managerial aspects of trusts, measuring trustee conduct against the conduct to be expected of a reasonable person with the trustee's knowledge, skills and characteristics.[3] It is true that these high objective standards are default rules, and are therefore capable of remoulding by the agreement of the parties. The spreading practice of exempting trustees from negligence liability may result in the reduction of their duties to lower levels than ever seen before. But I shall assume for now that the default rules are significant in setting a normative structure for the law's enforcement of duties, unrealistic though this assumption may be.[4]

In our present time of rapid doctrinal reform, it may be helpful to review the development of the equitable duty of care in trust management, and expose some of the paths that have led to the modern law. Knowledge of the doctrinal history may blunt the sense of novelty or vertigo left by the pace of recent change. This paper will therefore broach the past five hundred years of legal doctrine more than the past five. I will concentrate on the setting of duty of care standards, and will pay little attention to classification and taxonomy, since lawyers before the late twentieth century argued far more over the former than the latter. But one set of distinctions will be important—that between a purely subjective approach to liability, and two types of objective standard, one tailored to the individual, and one demanding adherence to a universalised standard. The subjective approach emerges from a stream of decided cases in older trust law finding no breach of the trustee's duty of care unless there be proof of "gross" negligence, "wilful" default or fraud proper. Any lesser default such as a lack of due skill was not usually enough. This focus on the intentions, actual

[2] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 (HL); *Bristol & West Building Society v Mothew (t/a Stapley & Co)* [1998] Ch 1; [1996] 4 All ER 698 (CA); *Armitage v Nurse* [1998] Ch 521; [1997] 2 All ER 705 (CA); *Swindle v Harrison* (1997) 4 All ER 705 (CA).

[3] Trustee Act 2000, s 1(1) and Sch 1. Higher standards still are exacted by the Pensions Act 1995 c 26.

[4] Cf T Frankel "Fiduciary Duties as Default Rules" (1995) 74 Oregon LRev 1209–1277.

knowledge or awareness of risk of the errant trustee does not really impose any standard at all, but represents a purely subjectivist approach, looking for a species of *mens rea* to ground liability. The language of fraud has a natural affinity with this subjectivist approach; hence by this approach, a well-meaning trustee who does his (sub-standard) best is not liable.[5] We may contrast this basis of liability with the two types of objective standard—first, that of the individual man with particular skills, abilities, and disposition,[6] who will be expected to use those individual skills to his own personal or habitual standard; and secondly, that of the generic reasonable or prudent man, in effect a policy construction of the law which thereby demands a common standard from all persons in defined relationships.[7] We shall see the courts constantly hovering between these three bases of liability—the subjectivist, the individualized and the generalized grounds—across four centuries of argument.

## B FROM PASSIVE TO ACTIVE TRUSTS

That a trustee should owe a duty of care to beneficiaries was first recognized—albeit tentatively—in the seventeenth century. The trust had developed from the late thirteenth century as the use, a custodial device affording landholders powers they would not have enjoyed as sole owners. Active management was not called for in the medieval and early modern forms of trust. The use was largely a passive form of custody; discretionary powers of disposition only develop in the early sixteenth century.[8] The chief custodial purposes of uses were five-fold: to avoid mortmain prohibitions in giving to the church; to permit ecclesiastics to enjoy collective wealth without legal ownership (and later, to protect the wealth of religious non-conformists); to create perpetual joint ownership in a group of trusted feoffees who would guard the legal title; to wield a full and secret power of disposition, both *inter vivos* and by will, through direction of feoffees; and finally, through these last dispositive powers, to escape the Crown's fiscal claims through avoidance of the feudal incidents on descent of land—wardship, marriage, relief, and ultimately, escheat.

The Crown was well aware of what the use was doing to the royal finances, and soon took vigorous action against equitable ownership. In *Lord Dacre's case* of 1535 the judges were coerced by Thomas Audley and Thomas Cromwell into declaring void the will-making power of uses. In the next year Henry VIII induced Parliament to pass the Statute of Uses, which converted ("executed")

[5] See *Armitage v Nurse* [1998] Ch 241, 254; [1997] 2 All ER 705 at 713f-h; and *Bristol & West Building Society v Mothew (t/a Stapley & Co)* [1998] Ch 1, 18; [1996] 4 All ER 698, 712, discussed below at text accompanying notes 28 and 118.

[6] The *locus classicus* for this analysis is Aristotle's *Ethics* (translated JAK Thomson, rev ed H Tredennick, Penguin Harmondsworth 1976) 1109b30–1115a5, pp 111–126.

[7] I am grateful to Peter Cane for helping me clarify these ideas.

[8] JH Baker *An Introduction to English Legal History* (3rd edn Butterworths, London 1990) 327–328.

uses into full legal titles vested in the cestuis, so restoring the value of feudal incidents.[9] After stirrings of rebellion the aristocracy submitted to the changed legal regime, mollified by the formal grant of testamentary power for land contained in the Statute of Wills of 1540. But the loss of the custodial and private dispositive powers of the feoffees to uses was too uncomfortable to be borne, and the double use or trust was soon developed by conveyancers to supply the want. In 1560 the judges decided that an active use upon a passive use would survive the operation of the Statute of Uses; the statute only executed the passive use, but would not interfere with a second use containing active powers and duties.[10] In this fashion active trust management became a structural element of the modern trust by the start of the seventeenth century. However, such active duties were not fundamental to the basic function of the trust, which remained a custodial device segregating the entrusted assets from creditors of the legal owners and binding (nearly all) third parties without requiring formal and public avowal of beneficial ownership.

There is considerable evidence that in the sixteenth century, ecclesiastical courts were also enforcing testamentary uses and trusts, as an extension of the jurisdiction over testamentary disposition of moveables. This could involve close monitoring of the quality of executors' management of estates. For example, in 1591 a case was brought to the bishop's court in Rochester, where an executor took an estate under an instruction "to see the children of [the testator] well brought up" through gradual payment of their portions. An action was brought by friends of the children alleging that the executor "had no regard of their bringing up, but wasteth their portions in so much that it is greatly doubtfull that their portions will be spent before they shall all come of age." The negligent executor had a *cautio* imposed requiring him to make over the portions as required. Roman ideas such as *fideicommissum* may have helped to provide vocabulary here.[11]

Chancery judges soon began to develop specifically equitable concepts of duty of care as they enforced the new trusts. It was the liability of the trustee to account for receipt of property that established a duty to manage with due care, over one hundred years after the Statute of Uses. Lord Nottingham in his treatises on Chancery practice of the early 1670s suggested that a trustee was chargeable for failing to produce the income that a reasonable manager could have produced with reasonable effort. Following Bartolus on usufruct, he stated that *mala fides* was a prerequisite of liability; the neglect had to be such as to indicate "wilful default". At its highest, wilful default was a fraudulent denial of the trust; but there could be a lesser case of "wilful neglect in the

9 27 Hen VIII c10.

10 *Bartie v Herenden* (1560) in JH Baker and SFC Milsom *Sources of English Legal History: Private Law to 1750* (Butterworths London 1986) 121–123.

11 R Helmholz "Trusts in the English Ecclesiastical Courts 1300–1640" in R Helmholz and R Zimmermann eds *Itinera Fiduciae: Trust and Treuhand in Historical Perspective* (Duncker & Humblot Berlin 1998) 153, 165–171.

managing".[12] Lord Nottingham applied this rule in *Palmer v Jones* (1678), holding a trustee liable for failing to raise best value from an estate according to the terms of the trust; in that case the trustee had merely put a shepherd into possession of the land. Nottingham's introjection of a duty of care into trust law was immediately diluted, however, by North LK, who on rehearing *Palmer v Jones* in 1682/3 doubted Nottingham's decision:

> This cause coming to be reheard, the Lord Keeper thought the former decree too severe upon Doctor Jones, the trustee; and declared he would never charge a trustee with imaginary values; but that he should be charged as a bailiff only. He thought it a great hardship, that a trustee was allowed nothing for his own labour and pains. It was answered, that it had often been complained of in court as too hard a rule to charge a trustee with what he had made, or might have made, without his wilful default; but the court could never yet find where else to fix a measure. The Lord Keeper said, that very supine negligence might indeed in some cases charge a trustee with more than he had received . . . but then the proof must be very strong.[13]

Early eighteenth century cases picked up North's less stringent approach, and this is the rule found in early abridgements and treatises, especially in relation to liability of trustees to pay interest in lieu of investment income. We will not understand these developments of early modern trust law adequately until more work is done on the crucially important operation of the action of account in equity and contract, and the rules governing awards of interest against defaulting trustees.[14]

## C CHIEF JUSTICE HOLT'S BAILMENT MODEL

The most important development after Nottingham in conceptualizing duties of custodianship and management came from outside Chancery trust law, in the closely analogous field of bailment. Traces of mixed trust-bailment analysis

[12] DEC Yale ed *Lord Nottingham's Manual of Chancery Practice and Prolegomena of Chancery and Equity* (CUP Cambridge 1965) 166–167, 196, 200. Bartolus was taken from Scots sources. The doctrine was also collected from common law account duties of guardians and factors.

[13] DEC Yale ed *Lord Nottingham's Chancery Cases* (Selden Society vol 79 London, 1961) 649, no. 824 (1678); (1683) 1 Vern 144; 23 ER 376.

[14] For this paragraph I have relied on M Macnair "The Conceptual Basis of Trusts in the Later 17th and Early 18th Centuries" in Helmholz and Zimmermann eds *Itinera Fiduciae*, (n 11 above), 207–236, esp at 224–229. On account: C Viner, *General Abridgement of Law and Equity* (published by the author himself Aldershot 1742–1753) "Account"; *Leigh v Dickeson* (1883) 12 QBD 194, 197–200 (Pollock B); EO Belsheim "The Early Action of Account" (1932) 45 Harvard LR 466; RM Jackson, *The History of Quasi-Contract in English Law* (CUP, Cambridge 1936) 9–17, 24–36; CHS Fifoot, *History and Sources of the Common Law: Tort and Contract* (Butterworths London 1949) 268–288; TFT Plucknett, *The Medieval Bailiff* (Athlorie Press London 1954) 22 ff; SJ Stoljar "The Transformations of Account" (1964) 80 LQR 203; AWB Simpson, *History of Contract at Common Law* (OUP Oxford 1975) 177–182, 499–501; S Elliott, "Rethinking Interest" [2001] Conv 313. I have also had the benefit of seeing unpublished research on agency by Mr Mark McGaw, of Wadham College, Oxford, and on guardianship by Mr Antonio Buti of Wolfson College, Oxford, each throwing light on the evolution of specific managerial duties in law and equity.

appear in sixteenth-century cases,[15] as in North LK's decision in *Palmer v Jones*; but the seminal case is *Coggs v Barnard* of 1703.[16] Here Lord Holt, in a self-consciously virtuosic display of learning, imported the Roman and Civilian categories of contractual duty of care into the English law of bailment. In so doing he also resorted to native concepts of trust. The facts of the case were that gratuitous bailees undertook to move a barrel of brandy from one cellar to another, but negligently spilt most of the contents. According to some reports the case was mainly about the assessment of damages; but Raymond's long report narrates that the defendant moved (unsuccessfully) for arrest of judgment on the basis that the pleadings did not allege that he was a common carrier (a special status supporting liability) nor a carrier for reward (allowing assumpsit founded on consideration). Holt CJ sought to establish the general grounds of liability for when "a man shall be charged with goods put into his custody." He made a six-fold division of types of bailment, basically tracking the classical Roman real contracts, and using Bracton as his bridge from Civilian to common law.

The first sort of bailment was *depositum*, a "bare, naked bailment" where the goods are kept for the use of the bailor only. According to Holt CJ,

> [the bailee] is not answerable, if they [the goods] are stolen without any fault in him, neither will a common neglect make him chargeable, but he must be guilty of some gross neglect. . . . There is I confess a great authority against me . . . But there is no reason nor justice in such a case of a general bailment, and where the bailee is not to have any reward, but keeps the goods merely for the use of the bailor, to charge him without some default in him. *For if he keeps the goods in such a case with an ordinary care, he has performed the trust reposed in him*. . . . reason is strong against the case to charge a man for doing such a friendly act for his friend, but so far is the law from being so unreasonable, that such a bailee is the least chargeable for neglect of any. *For if he keeps the goods bailed to him, but as he keeps his own, though he keeps his own but negligently, yet he is not chargeable for them, for the keeping them as he keeps his own, is an argument of his honesty*. . . . As suppose the bailee is an idle, careless, drunken fellow, and comes home drunk, and leaves all his doors open, and by reason thereof the goods happen to be stolen with his own; yet he shall not be charged, because it is the bailor's own folly to trust such an idle fellow. So that this sort of bailee is the least responsible for neglects, and under the least obligation of any one, being bound to no other care of the bailed goods, than he takes of his own. This Bracton[17] I have cited is, I confess, an old author, but in this his doctrine is agreeable to reason, and to what the law is in other countries. The civil law is so, as you have it in Justinian's Inst.[18] . . . So that a bailee is not charge-

[15] *Southcote v Bennet* (1601) in Baker and Milsom, *Sources of English Legal History*, 274–277; N Jones "Trusts in England after the Statute of Uses: A View from the 16th Century" in Helmholz and Zimmermann eds *Itinera Fiduciae* (n 11 above) 173, 202–203.

[16] Sub nom *Coggs v Bernard* (1703) 2 Ld Raym 909; 92 ER 107; SC 3 Ld Raym 163; Comyns 133; Holt 13, 131, 528; 1 Salk 26; 2 Salk 735; 3 Salk 11, 268; BL MS Hargrave 66, ff. 85–106.

[17] Bracton lib 3, c 2, 99b.

[18] Justinian Inst 3.14.3.

able without an apparent gross neglect. *And if there is such a gross neglect, it is looked upon as an evidence of fraud*.[19]

This category of gratuitous bailee, who takes the goods for the use of the bailor only, is very close to the case of an unremunerated trustee; and we shall see that many nineteenth-century courts almost mimetically reproduce Holt CJ's opinions on *depositum* when they come to decide upon not only bailment cases[20] but also the trustee's duty of care. The standard imposed in this category lies somewhere between two Civilian standards of care in contract. It partakes of *diligentia quam suis rebus*, the habitual or ordinary care one brings to one's own affairs, labelled in Civilian sources as *culpa levis in concreto*. Ordinary care under this heading means the individualized standard of the bailee, not the standard of an objectively reasonable manager, or *culpa levis in abstracto*. But there is also language in Holt CJ's judgment applying the still lower Roman standard of *culpa lata*, involving *crassa negligentia* or gross neglect. In this category, liability was found only for negligent conduct so extreme in its ignorance or recklessness as to count as equivalent to or evidence of *dolus* or subjective fraud. English law historically has tended to apply the two lowest categories of *culpa levis in concreto* and *culpa lata* to trust management; the duty of care has typically been measured either by the low *quam suis rebus* standard or the even lower *crassa negligentia* standard. Moreover the justifications for this low level of duty of care follow Holt CJ, arguing from the voluntary nature of undertakings based on friendship, and because the entrustor is to blame for using an untrustworthy friend as custodian.

The second level of liability for Holt CJ is for "commodatum or lending gratis," and here, because the bailee enjoyed the use of the goods for no payment, he is bound to "the strictest care and diligence," and will be liable for the slightest neglect, which seems to mean any significant contribution to a causal chain resulting in loss. Theft or force by third parties were not chargeable as the chain of causation did not include any action by the bailee. Holt CJ cites Bracton but not Justinian Inst. 3.14. for this rule; he also does not pursue the classical category of *mutuum*, where the taker of the goods becomes owner with a duty to replace the goods to similar value.

The third type of liability in Holt CJ's schema is that of "locatio or lending for hire", and the liability is similar to *commodatum*. Holt CJ again cites Bracton and through him Justinian:

[19] 2 Ld Raym 909, 916; 92 ER 111 (all emphases in text added).

[20] *Coggs v Barnard* is applied *inter alia* in *Boorman v Brown* (1842) 3 QB 526; 11 Cl & Fin 1; *Ross v Hill* (1846) 2 CB 890; 135 ER 1190; *Donald v Suckling* (1866) LR 1 QB 594; *Skelton v London and North-Western Railway Company* (1867) LR 2 CP 636; *Readhead v Midland Railway Company* (1869) LR 4 QB 382; *Giblin v M'Mullen* (1869) LR 2 PC 336; *Searle v Laverick* (1874) LR 9 QB 122; *Liver Alkali Company v Johnson* (1874) LR 9 Ex 340; *Nugent v Smith* (1875–76) 1 CPD 24, 423; *Harris v Great Western Railway Company* (1876) 1 QBD 529; *Bergheim v Great Eastern Railway Company* (1878) 3 CPD 223; *The Moorcock* (1889) 14 PD 70; *Shaw v Great Western Railway Company* [1894] 1 QB 380; *The Winkfield* [1902] 12 P 59; *Harris v Perry* [1931] 2 KB 226; *Cheshire v Bailey* [1905] 1 KB 242.

[I]f goods are let out for a reward, the hirer is bound to the utmost diligence, such as the most diligent father of a family uses; and if he uses that, he shall be discharged. But every man, how diligent soever he be, being liable to the accident of robbers, though a diligent man is not so liable as a careless man, the bailee shall not be answerable in this case, if the goods are stolen.[21]

The two-part duty of strict diligence, that *exacta diligentia* required of the *bonus paterfamilias*, comprises the classical definition of the Civilian's *culpa levis in abstracto*.[22] We shall see how the *bonus paterfamilias* part of this liability strays into trust language in the late nineteenth century, as a device to intensify the duty of care.

For category four, pawn, Holt CJ vaguely follows Roman *pignus* doctrine; but here he is scarcely coherent. Category five, remunerated bailment, is far more interesting:

[A] delivery to one that exercises a publick employment, . . . and he is to have a reward, he is bound to answer for the goods at all events. And this is the case of the common carrier, common hoyman, master of a ship, &c. The law charges this person thus intrusted to carry goods, against all events but acts of God, and of the enemies of the King. For though the force be never so great, as if an irresistible multitude of people should rob him, nevertheless he is chargeable. And this is a politick establishment, contrived by the policy of the law, for the safety of all persons, the necessity of whose affairs oblige them to trust these sorts of persons, that they may be safe in their ways of dealing; for else these carriers might have an opportunity of undoing all persons that had any dealings with them, by combining with thieves, &c. and yet doing it in such a clandestine manner, as would not be possible to be discovered. And this is the reason the law is founded upon in that point.[23]

The resonance with certain doctrines of developed trust law is great: the power of the controlling bailee over those who trust him is so unequal, and the capacity for concealed fraud so enormous, that a prophylactic deterrent liability of strictest extent is imposed. For remunerated bailees not of common calling, such as factors, a mere reasonableness standard is imposed: "it would be unreasonable to charge him with a trust, farther than the nature of the thing puts it in his power to perform it."

The sixth category of bailment has even closer affinities to the trust duty of care. It concerns the bailee who

is to have no reward for his pains, but yet that by his ill management the goods are spoiled. . . . The bailee having undertaken to manage the goods, and having managed

[21] 2 Ld Raym 909, 917; 92 ER 107, 112.

[22] For the Roman standards of care generally, see R Zimmermann, *The Law of Obligations: Roman Foundations of the Civilian Tradition* (Juta Cape Town 1990; OUP Oxford 1996) 188–229, 374–377; 426–432; 607; 1004–1013; 1027–1030; D Ibbetson "'The Law of Business Rome': Foundations of the Anglo-American Tort of Negligence" [1999] Current Legal Problems 74, 81–87 ff; WW Buckland, *A Textbook of Roman Law* (3rd edn by PG Stein, CUP Cambridge 1963) 556–559; JAC Thomas, *Textbook of Roman Law* (North Holland Amsterdam 1976) 249–254, 271–278.

[23] *Coggs v Barnard* (1703) 2 Ld Raym 909, 917; 92 ER 107, 112.

them ill, and so by his neglect a damage has happened to the bailor . . . it is called mandatum. It is an obligation which arises ex mandato. It is what we call in English an acting by commission, and if a man acts by commission for another gratis, and in the executing his commission behaves himself negligently, he is answerable.

Quoting from Justinian Inst.3.26, Bracton and Vinnius, Holt CJ holds that

This undertaking obliges the undertaker to a diligent management. . . . The reasons are, first, because in such a case, a neglect is a deceipt to the bailor. For when he intrusts the bailee upon his undertaking to be careful, he has put a fraud upon the plaintiff by being negligent, his pretence of care being the persuasion that induced the plaintiff to trust him. And a breach of a trust undertaken voluntarily will be a good ground for an action.[24]

In other words, the lack of agreed care, where the agreement induces the bailment, amounts to fraud of itself; the carelessness is not evidence of fraud, as it was in category one deposit.

I have gone into Holt CJ's great judgment in such detail because trust authorities over the next century and a half basically recycle his arguments. Those trust authorities swing between the low standard of Holt's category one and the higher standard of category six in describing the trustee's duty of care, with occasional swerves into the language of categories two, three and five. It would be interesting to know how consciously Civilian concepts were used as judges defined the duty of care in trusteeship.[25] There was really little else to build

[24] *Coggs v Barnard* (n 23 above) 918–919, 113.

[25] David Ibbetson in *A Historical Introduction to the Law of Obligations* (OUP Oxford 1999) 164–187 and "The Law of Business Rome" (n 22 above), argues for the pervasive influence of Roman ideas in eighteenth and nineteenth century tort law, with trustee liability appearing as a sub-branch, a Chancery echo, of evolving negligence doctrines. The thesis is persuasive and my debt to his work is heavy; though my emphases are slightly different. Ibbetson stresses the importance of treatise literature in cultivating Romanist tort standards of care in the common law, pre-eminently William Jones *Essay on the Law of Bailments* (J Nichols London 1781). I would emphasize the importance of the custody and trust standards trailed by *Coggs v Barnard* in the evolution of doctrine; Jones' *Essay on Bailments* can be seen as an elaborate gloss on that case, important chiefly in disseminating Holt's theories: see eg *Crook v Wright* (1825) Ryan & Moody 278, 171 ER 1020; *Shillibeer v Glyn* (1836) 2 M & W 143, 150 ER 704; *Taylor v Caldwell* (1863) 3 Best & Smith 826, 122 ER 309. Judges did often cite *Jones on Bailments* as an authority, eg Shiells *v* Blackburne (1789) 1 H Bl 158, 126 ER 94; but in the mid-to-late nineteenth century courts came to rely on Joseph Story's *Commentaries on the Law of Bailments* (J Richards London 1839 and many editions on both sides of the Atlantic) as the more accurate and modern treatment of common-law civil sources: see eg *Butt v Great Western Railway Company* (1851) 11 CB 140, 138 ER 424; *Cashill v Wright* (1856) 6 El & Bl 891, 119 ER 1096; *European and Australian Royal Mail Company Limited v Royal Mail Steam-Packet Company* (1858) 4 Kay & Johnson 676, 70 ER 281; *Swinfen v Lord Chelmsford* (1860) 5 H & N 890, 157 ER 1436; *South Australian Insurance Company v Randell* [1869] 6 Moo NS 341, 16 ER 755. *Story on Bailments* was a sophisticated blend of English and American case-law on many aspects of agency and hire as well as bailment, presented together with Digest sources, Civilian writing, especially Domat and Pothier, and a fair amount of natural law (see eg text accompanying n 75, below). In the 1839 edition (Preface, pp xxiii–xxviii) Story makes a lengthy apologia for using continental sources to supply the gaps and architectural defects of the common law. It transpires that in many leading English cases of the nineteenth century, *Story* is cited and *Jones* ignored: see eg *Harris v Birch* (1842) 9 M & W 591, 152 ER 249; *Smart v Sandars* (1846) 3 CB 380, 136 ER 152;

from; the modern concept of a general negligence standard as evoked in *Donoghue v Stevenson* was not fully available to jurists during the formative period of trust law; Justinian and *Coggs v Barnard* were available.

A coda: Holt CJ seems to have applied his sixth category to the barrel-rollers before him in court, and he accordingly found them liable for negligence. He concluded:

I have said thus much in this case, because it is of great consequence, that the law should be settled in this point, but I don't know whether I may have settled it, or may not rather have unsettled it.[26]

## D GROSS NEGLIGENCE AND ORDINARY NEGLIGENCE

In Millett LJ's 1997 judgment in *Armitage v Nurse* a powerful argument is made that the modern common law has rejected the distinction between gross and ordinary negligence:

It would be very surprising if our law drew the line between liability for ordinary negligence and liability for gross negligence. In this respect English law differs from civil law systems, for it has always drawn a sharp distinction between negligence, however gross, on the one hand and fraud, bad faith and wilful misconduct on the other. The doctrine of the common law is that: "Gross negligence may be evidence of mala fides, but is not the same thing:" see *Goodman v Harvey* (1836) 4 A. & E. 870, 876, per Lord Denman C.J. But while we regard the difference between fraud on the one hand and mere negligence, however gross, on the other as a difference in kind, we regard the difference between negligence and gross negligence as merely one of degree. English lawyers have always had a healthy disrespect for the latter distinction. In *Hinton v Dibbin* (1842) 2 Q.B. 646 Lord Denman C.J. doubted whether any intelligible distinction exists; while in Grill v. General Iron Screw Collier Co. (1866) L.R. 1 C.P. 600, 612 Willes J. famously observed that gross negligence is ordinary negligence with a vituperative epithet.[27] But civilian systems draw the line in a different place. The doctrine is culpa lata dolo aequiparatur; and although the maxim itself is not Roman the principle is classical. There is no room for the maxim in the common law . . .[28]

This point was raised by Millett LJ in the particular context of deciding whether there are core managerial duties immune to exemption of liability in trustee indemnity clauses, such as a duty to eschew grossly negligent behaviour.

*Clements v Flight* (1846) 16 M & W 42, 153 ER 1090; *Benett v Peninsular and Oriental Steam-Boat Company* (1848) 6 CB 775, 136 ER 1453; *Sheridan v New Quay Company* (1858) 4 CBNS 618; 140 ER 1234; *Reeve v Palmer* (1858) 5 CBNS 84, 141 ER 33; *Williams v Jones* (1864–5) 3 H & C 256, 602, 159 ER 528, 668 *Peninsular and Oriental Steam Navigation Company v Shand* [1865] 3 Moo NS 272, 16 ER 103. There are many other areas of nineteenth-century English common law influenced by Continental influences via American jurists such as Story and Chancellor James Kent.

[26] *Coggs v Barnard* (1703) 2 Ld Raym 909, 920; 92 ER 107, 114.

[27] Willes J took this quip from Rolfe B; see *Wilson v Brett* (1843) 11 M & W 113, 152 ER 737, discussed below at text accompanying nn 51–52.

[28] *Armitage v Nurse* [1998] Ch 241 (CA) 254; [1997] 2 All ER 705, 713f–h.

The rejection of gross negligence by the Court of Appeal in this context does not imply that the concept of gross negligence played no part in the development of legal and equitable duties and standards of care; nor need it imply that differential duties of care cannot operate usefully in trust law.[29] We must therefore treat the concept of gross negligence with some care, even if we do not wish it to play a strong part in modern trust and tort doctrine.

Three conceptions of gross negligence can be identified in the legal sources; each is identified by Millett LJ's judgment in *Armitage* in the passage above.

### 1 The Model of Excess

The first model of gross negligence is the "vituperative epithet" idea, namely that gross negligence is nothing but excessive negligent behaviour, assessed as a matter of impression and degree, but really of no different quality than ordinary negligence. This is the dismissive conception of gross negligence most often used in today's common law; but at an earlier date this model had more content. In a system of civil justice where juries determined fault until the early 1930s,[30] judges would speak of gross or ordinary negligence in order to guide the jury to the desired finding of fact. The epithet therefore loses much of its resonance with the passing of the civil jury. Such ideas are indicated negatively in *Dixon v Wilson*,[31] where it was denied that the court wielded a summary jurisdiction to discipline solicitors for even a grossly negligent loss of a trial. The case that the attorney lost was a technical Chancery action said to be too hard for a run-of-the-mill lawyer to manage; it was held that there must be a proper jury trial at law for negligence, however protracted and inconvenient; the choice of a summary forum for trying the solicitor's failure should not be made to depend on a court's appraisal of degree of fault.

### 2 The Evidential Model

Falling below due standards very far may raise a suspicion, or an inference, or at its highest, a factual presumption, of fraud. An old common law example is *Backhouse v Harrison*.[32] The defendant was the indorser of two bills of exchange that were negligently dropped in a canal. A finder fraudulently presented them to the plaintiff bank, which cashed them despite the bills' dirty condition and the presenter's illiteracy. Counsel for the bank argued that the

[29] Cf *Bartlett v Barclays Bank Trust Co Ltd (Nos 1 & 2)* [1980] Ch 515, discussed below at n 116.
[30] J Getzler "The Fate of the Civil Jury in Late Victorian England: Malicious Prosecution as a Test Case" in K O'Donovan and G Rubin (eds) *Human Rights and Legal History: Essays in Honour of Brian Simpson* (OUP Oxford 2000) 205–224.
[31] (1859) 4 Drewry 614; 62 ER 235 (Kindersley VC).
[32] (1834) 5 Barn & Ad 1098; 110 ER 1099.

indorser's failure to publicize the loss of the bills was a contributory negligence, and this raised an estoppel blocking the indorser's defence, based in turn on the bank's negligence. The court held that the bank had shown a want of ordinary prudence, but not gross negligence, and hence the bank could sue on the bills, without need to raise the defensive estoppel. Patteson J further stated that gross negligence would not be found unless it was strong enough to betoken bad faith.

Equity's broad language of fraud as a general showing of bad faith[33] often partakes of this presumptive model, whereby gross negligence is taken as an indication of "constructive" fraud. According to Lord Eldon's description, "there must be positive fraud or concealment, or, negligence so gross as to amount to fraud." The defendant's interests in such a case were protected in that he could rebut hostile witnesses by giving his own favourable evidence in a Court of Equity, unlike the law courts where parties could not be witnesses. With that allowance and protection, there might yet be "evidence resting upon that high degree of probability upon which the Court, guided by its conscience must act, that this trustee had a fraudulent purpose . . . negligence so gross as to amount to constructive fraud . . . such evidence of fraud, that [the trustee] shall not be heard in a Court of justice to say, there was not fraud."[34] More succinctly, in *Hewitt v Loosemore*[35] Turner VC held that "gross and wilful negligence . . . in the eye of this Court, amounts to fraud." The doctrine was commonly applied where a first mortgagee failed to get in or locate the title deeds, permitting a later mortgage to be made by the borrower; the first mortgage was to be postponed to the later mortgage only in a case of fraud or "gross or wilful negligence"; but if there had been a bona fide inquiry after the deeds and a reasonable excuse was given, the court would not impute the necessary *culpa*; though it would so impute if no inquiry was made, thereby suggesting a wilful ignorance.[36] In *Colyer v Finch*[37] the House of Lords adopted the gross negligence doctrine for postponement of mortgages, but made the test more individualized: did the person taking the security do all that a person in his position might be expected to do to secure the title deeds? A failure to take the precautions of an experienced property professional might be negligent but was

[33] *Earl of Chesterfield v Janssen* (1751) 2 Ves Sen 125; 28 ER 82; *Earl of Aylesford v Morris* (1873) LR 8 Ch App 484, 490–491 (Lord Selborne LC).

[34] *Evans v Bicknell* (1801) 6 Vesey Jun 174, 191–192; 31 ER 998, 1006 (Lord Eldon LC). Note also *Evans v Bicknell* at 184–187; 1003–1004 for Lord Eldon's criticisms of *Pasley v Freeman* (1789) 3 TR 51; 100 ER 450, where Kenyon CJ propounded a common-law version of the presumptive fraud doctrine, but without the benefit of chancery's evidential procedures.

[35] (1851) 9 Hare 449, 457–458; 68 ER 586, 589–590 (VC).

[36] See further *Plumb v Fluitt* (1791) 2 Anst 432; 145 ER 926; *Evans v Bicknell* (1801) 6 Ves Jun 174; 31 ER 998 (Lord Eldon LC); *Barnett v Weston* (1806) 12 Ves 130; 33 ER 50; *Harper v Faulder* (1819) 4 Madd 129; 56 ER 656; *Martinez v Cooper* (1826) 2 Russ 198 at 217; 38 ER 309 at 317 (Lord Eldon LC); *Farrow v Rees* (1840) 4 Beav 18; 49 ER 243; *Allen v Knight* (1846) 5 Hare 272; 67 ER 915; *Worthington v Morgan* (1849) 16 Sim 547; 60 ER 987; *Roberts v Croft* (1857) 2 De Gex & Jones 1; 44 ER 887; *Carter v Carter* (1857) 3 Kay & Johnson 617; 69 ER 1256; cf *Pilcher v Rawlins* (1870–72) LR 11 Eq 53; LR 7 Ch Ap 259.

[37] [1856] 5 HLC 905, 928–9; 10 ER 1159, 1168–9 (HL).

not culpable gross negligence. Making the gross negligence standard attentive to the personal circumstances and qualities of the wrongdoer pulled that standard strongly towards the factual presumption of fraud model.

This presumptive concept of fraud was a little distant from the core meaning of equitable fraud as used in Chancery, which was not culpability as such or falling below a standard, but rather unconscionability in the sense of abuse of a power or superiority in order to take an advantage, whether through advertent dishonesty or inadvertent insensitivity to or ignorance of another's interests. A telling example is the doctrine that an exceeding of dispositive powers was a "fraud on powers", and was "corrupt and void" for ultra vires, as a matter of strict liability, however careful or beneficent the donee of the power had been in its exercise. The abuse of superiority was the essential vice.[38] Hence we should be careful to note how Roman *culpa* ideas were engrafted onto the native model of good conscience with its subjectivist overtones.

## 3 The Model of Assumed or Special Duty

The third model of gross negligence at law is equivalent to Holt CJ's sixth concept of bailment, the idea that, where one induces trust by promising or assuming a duty of care, one breaches that specific trust by squarely falling below the assumed duty. Here gross negligence has the technical meaning of breaching a specifically defined duty, and in the case law is often associated with what would today be named professional negligence, or falling below the habitual standard of one's calling. To illustrate: a surgeon promises he will take care not to cause harm during a procedure, and this undertaking secures consent to the operation. If the patient is harmed by the surgeon's lack of care, even if the negligence is slight, his special or express assumption of responsibility makes this "gross" as opposed to ordinary negligence; the breach of express reliance intensifies the wrongfulness of the behaviour. This meaning is found in *Bulmer v Gilman*,[39] a case concerning gross negligence by a parliamentary agent in obscurely drafting a bill. Cresswell J speaks of breach of requirement of competent skill, suggesting that gross negligence means breach of uncommon duty, though he suggests that expert witness might then be required to determine the duty's content.

[38] *Aleyn v Belchier* (1758) 1 Eden 132; 28 ER 634; *Sugden on Powers* (7th edn S Sweet London 1845) vol 2, 299–300; *Farwell on Powers* (Stevens London 1874) 325, 352–353. It was a concomitant doctrine that a risky exercise of trust powers made with the consent of the beneficiaries prima facie could not be void through eg negligence. In *Chambers v Chambers* (1730) Mosely 333; 25 ER 424, £6,000 was put in the hands of trustees "to be put out on Government, or other securities, at the discretion of the trustees till a proper purchase [of land] could be found". Half the sum was lost following investment in South Sea stock. Talbot, counsel for the plaintiff-beneficiaries, conceded that the trustees could not be liable, due to their express authority to invest, or alternatively because of the consent of the beneficiaries (SC Fitzgibbon 127; 94 ER 684). The rest of the case concerned averaging of the loss amongst various beneficiaries.
[39] (1842) 4 Man & G 108; 134 ER 45.

"Gross" negligence under this heading might betoken the use of an objective standard of a profession, as opposed to the individualized or habitual standard of an individual. In *Godefroy v Dalton*[40] an assumpsit claim was brought against a defence attorney for mishandling of extra-curial work; due to lack of due skill and diligence he did not have a copy of the essential preceding court action, causing the case to be lost at hearing. Tindal CJ inquired into the line between due and reasonable skill and diligence of an attorney in such a case, "and that crassa negligentia, or lata culpa mentioned in some of the cases, for which he is undoubtedly responsible." He found a want of objectively reasonable care and skill, but since it was possible that a man of the defendant's lesser skills would act thus, then this was not a case of gross negligence which alone could make the defendant answerable as a professional attorney.[41] In *Hunter v Caldwell*,[42] another case of attorney's negligence, counsel argued that the trial judge ought to have directed the jury to look for "that crassa negligentia for which alone an attorney could be responsible in damages." Denman CJ ruled that "we think the question of negligence was a question of fact for the jury, although, like many others which turn on matters of law, it was proper to direct the jury positively as to the premises from which they were to draw their conclusion. Thus it was the province of the Judge to inform the jury for what species or degree of negligence an attorney was properly answerable, and what duty . . . was cast upon him." Again, it was held to be common practice for the judge to take expert witness in order to determine the appropriate level of care required from a profession or common calling, and thus remove discretion from the jury in fixing the standard of liability.

In the same category of special or assumed duty was the ship-master's duty to keep the ship entrusted to him as if it were his own. His status as a professional ship-master meant that the courts tended to call any breach of his special duty a "gross" negligence, even if the breach was slight.[43] Similar was the duty of the mortgagor not to allow deterioration of the security; in 1836 Alderson B stated that Exchequer required gross negligence for liability, distinguishing this level of *culpa* from both fraud and common negligence. In another mode, the modern criminal law to the present day punishes "grossly negligent" homicide as manslaughter, as an offence separate both from the civil wrong of negligently causing death and the crime of reckless slaying as murder. Grossly negligent manslaughter can be seen to involve breach of a specific and distinct duty not to kill by exorbitant carelessness. The gross negligence standard in homicide has some lineage;[44] and after a period in abeyance,

[40] (1830) 6 Bing 460; 130 ER 1357.

[41] *Godfrey v Dalton* (n 40 above) 468–469; 1361.

[42] (1847) 10 Queen's Bench 69, 82–83; 116 ER 28, 32–33. To similar effect: *Purves v Landell* (1845) 12 Cl & Fin 91; 8 ER 1332 (Lord Brougham).

[43] See cases collected at n 56, below.

[44] Eg, *R v Markuss* (1864) 4 Foster & Finlason 356; 176 ER 598 (Crown Cases) (Willes J, a case of lethal patent medicines made up by a grossly negligent pharmacist. See also *Ruddock v Lowe* (1865) 4 Foster & Finlanson 519; 176 ER 672.

is now back in full flood.[45] From these various instances it may be collected that where negligence is described as "gross", that often has an artificial lawyers' meaning speaking of a specific duty, and this is only distantly connected to the plainer meaning of "great" or "exorbitant" negligence.

The doctrine that gross negligence meant breach of a special or assumed duty left open the question of the appropriate standard. Judges in the 1860s found it difficult to make a clear rule, and might simply evade deciding the issue. In *Belfast and Ballymeena Railway Co. v Keys* in 1861,[46] counsel argued over application of the gross negligence standard to gratuitous bailees as opposed to liability for slight fault or strict liability, citing *Coggs v Barnard*, the treatises of Jones and Story and much other authority. However the six judges and four lords hearing the proceeding in error preferred to fix a low standard of care based on the contractual terms of the carrier rather than to pronounce more generally on the nature of liability in bailment. Three years later in *Beal v South Devon Railway*, Crompton J in the Exchequer Chamber ratcheted up the standard, agreeing with Pollock CB in the Court of Exchequer[47] "that for all practical purposes the rule may be stated to be, that the failure to exercise reasonable care, skill, and diligence, is gross negligence," which sounded more like *culpa levis in abstracto* than *in concreto*. In *Beal* it was also stated that a remunerated bailee was clearly held to an objective standard, namely the ordinary and proper diligence of the trade.[48] In 1866 in *Grill v The General Iron Screw Collier Company*,[49] Willes J held that:

> Confusion has arisen from regarding negligence as a positive instead of a negative word. It is really the absence of such care as it was the duty of the defendant to use. A bailee is only bound to use the ordinary care of a man, and so the absence of it is called gross negligence. A person who undertakes to do some work for reward to an article must exercise the care of a skilled workman, and the absence of such care in him is negligence. Gross, therefore, is a word of description, and not a definition, and it would have been only introducing a source of confusion to use the expression gross negligence, instead of the equivalent, a want of due care and skill in navigating the vessel, which was again and again used by the Lord Chief Justice in his summing up.

The Privy Council further tilted the gross negligence standard towards objectivity in the major 1869 case of *Giblin v M'Mullen*.[50] The case involved the taking of railway debentures from a strong box at a bank in Melbourne by the night clerk. The bank was sued as gratuitous bailee. Lord Chelmsford found that the correct standard was the ordinary diligence of a reasonably prudent man, breach of which was described as gross negligence. The objective standard

[45] *R v Prentice* [1994] QB 302; *R v Adomako* [1995] 1 AC 171; *A-G's Reference (No. 2 of 1999)* [2000] QB 796.
[46] (1861) 9 HLC 556; 11 ER 846 (HL).
[47] *Beal v South Devon Railway Co* (1860) 5 H & N 876, 884–885; 157 ER 1431, 1434.
[48] See further Ibbetson *The Law of Business Rome* above 102–103.
[49] (1866) LR 1 CP 600, 612.
[50] [1869] 5 Moo NS 434; 16 ER 578 (PC).

could be collected from the bank's own habitual practices; since the bank had protected the debentures with the same care that it had reasonably protected all its other assets; there was no gross negligence. The core passages are these:

From the time of Lord Holt's celebrated judgment in *Coggs v Bernard*,[51] in which he classified and distinguished the different degrees of negligence for which the different kinds of Bailees are answerable, the negligence which must be established against a gratuitous Bailee has been called "gross negligence." This term had been used from that period, without objection, as a short and convenient mode of describing the degree of responsibility which attaches upon a Bailee of this class. At last, Lord Cranworth (then Baron Rolfe), in the case of *Wilson v Brett* (11 M. and W. 113), objected to it, saying that he "could see no difference between negligence and gross negligence; that it was the same thing, with the addition of a vituperative epithet."

And this critical observation has been since approved of by other eminent Judges. Of course, if intended as a definition, the expression "gross negligence" wholly fails of its object. But as there is a practical difference between the degrees of negligence for which different classes of Bailees are responsible, the term may be usefully retained as descriptive of that difference, more especially as it has been so long in familiar use, and has been sanctioned by such high authority as Lord Holt, and Sir William Jones in his Essay on the Law of Bailments.

In the case of *Grill v The General Iron Screw Collier Company*,[52] Mr. Justice Willes, after agreeing with the dictum, of Lord Cranworth, and stating that the same view of the term "gross negligence" was held by the Exchequer Chamber in *Beal v The South Devon Railway Company*,[53] said, "Confusion has arisen from regarding negligence as a positive instead of a negative word. It is really the absence of such care as it was the duty of the Defendant to use." It is hardly correct to say, that the Court of Exchequer Chamber in the case referred to adopted the view of Lord Cranworth as to the impropriety of the term " gross negligence." Mr. Justice Crompton, in delivering the opinion of the Court, said, "It is said that there may be difficulty in defining what gross negligence is, but I agree in the remark of the Lord Chief Baron in the Court below, where he says, 'There is a certain degree of negligence to which every one attaches great blame. It is a mistake to suppose that things are not different because a strict line of demarcation cannot be drawn between them;'" and he added, "for all practical purposes the rule may be stated to be, that the failure to exercise reasonable care, skill, and diligence, is gross negligence." Mr. Justice Montague Smith, in the case in which the above-mentioned observations of Mr. Justice Willes were made, said, "The use of the term 'gross negligence' is only one way of stating that less care is required in some cases than in others, as in the case of gratuitous Bailees, and it is more correct and scientific to define the degrees of care than the degrees of negligence." The epithet " gross," is certainly not without its significance. The negligence for which, according to Lord Holt, a gratuitous Bailee incurs liability is such as to involve a breach of confidence or trust, not arising merely from some want of foresight or mistake of judgment, but from some culpable default. No advantage would be gained by substituting a positive for a negative phrase, because the

[51] Above, n 16.
[52] (1866) LR 1 CP 600 at 612; see text accompanying n 49 above.
[53] (1864) 3 H & C 337 at 341–342; 159 ER 560, 562.

degree of care and diligence which a Bailee must exercise corresponds with the degree of negligence for which he is responsible, and there would be the same difficulty in defining the extent of the positive duty in each case as the degree of neglect of it which incurs responsibility.

In truth, this difficulty is inherent in the nature of the subject, and though degrees of care are not definable, they are with some approach to certainty distinguishable; and in every case of this description in which the evidence is left to the jury, they must be led by a cautious and discriminating direction of the Judge to distinguish, as well as they can, degrees of things which run more or less into each other.

It is clear, according to the authorities, that the Bank in this case were not bound to more than ordinary care of the deposit intrusted to them, and that the negligence for which alone they could be made liable would have been the want of that ordinary diligence which men of common prudence generally exercise about their own, affairs.

Lord Chelmsford quoted and approved the Massachusetts case of *Foster* et al *Executors v The Essex Bank*,[54] where the cashier and clerk of a bank stole bullion and coin from the strongroom. As this was a "mere naked bailment for the accommodation of the Depositor and without any advantage to the Bank [it] was answerable only for gross negligence or for fraud . . . and that gross negligence certainly could not be inferred . . . as the same care was taken of the Plaintiff's property as of other deposits, and of the property belonging to the Bank itself."

## E GROSS NEGLIGENCE AND THE PRUDENT MAN TEST

From *Giblin v M'Mullen* we have the association of gross negligence with the objective standard, namely the ordinary diligence of the prudent man, counterposed to the subjective standard of ordinary care as practised habitually by an individual in relation to his own assets. The "prudent man" test found scattered through the case law has a separate derivation to the gross negligence test. One stream of older authority[55] concerns the liability of the ship master of an uninsured vessel to act as agent for the owner and anticipate what a man of common prudence would do with his own property in deciding whether to repair or abandon ship. In such a case a reasonable and bona fide decision, even if wrong, was not to bring liability.[56] In bill of exchange cases, judges might similarly use the language of prudence to impose a higher standard of negligence than habitual practice. In the 1824 case of *Gill v Cubitt*[57] Abbott CJ stated:

[54] (1835) 17 Mass Reps 478.
[55] See eg, *Mors v Slew* (1673) 3 Keble 112; 84 ER 624.
[56] *Benson v Chapman* [1849] 2 HLC 696; 9 ER 1256 (HL); and see *Young v Turing* (1841) 2 Man & G; 133 ER 883; *Irving v Manning* [1847] 1 HLC 287; 9 ER 766 (HL); *Lindsay v Leathley* (1863) 3 *Foster & Finlason* 902; 176 ER 410; *The Kong Magnus* [1891] P 223.
[57] (1824) 3 B & C 466, 475; 107 ER 806, 810. The case was questioned in *Bank of Bengal v Fagan* [1849] 5 Moo Ind Ap 27, 18 ER 804 (PC (Lord Brougham). In *London Joint Stock Bank v Simmons*

It [is] also a fit and proper question for [jury] consideration, (when the point to be decided is whether a man has acted bonâ fide or not,) whether he has inquired with that degree of caution which, in the ordinary course of trade, a prudent trader ought to use. . . . [I]t appears to me to be material for the interests of trade, to lay down as a rule that a party cannot in law be considered to act bona fide, or with due caution and due diligence, if he takes a bill of exchange from a person whose features alone he knows, without knowing what his name is, where he lives, or whether he is a person with whom he has been in the habit of trading. If we were to say that in this instance there had been due caution, it would certainly be giving a great facility to the disposal of bills of exchange which have been lost or stolen, by persons who have found or dishonestly obtained them.

Another influential source of objective standards of care came from nuisance law, where the maxim *sic utere tuo ut alienum non laedas* ("so use your own as not to harm that of another's") imposed a duty of mutual reasonableness on rival owners. In *Vaughan v Menlove*[58] a landowner was tried for negligently building a hay-rick on the edge of his land, so that when the hay ignited spontaneously it burnt down his neighbour's house. The defendant brought a nonsuit, claiming that the judge at trial ought not have instructed the jury to apply the gross negligence standard of ordinary prudence, which some authorities held to be meaningless,[59] but rather ought to have applied a subjective test, namely whether the well-meaning but unintelligent defendant had acted bona fide according to his best judgement. Tindal CJ rejected the subjective best judgement standard:[60]

That . . . would leave so vague a line as to afford no rule at all, the degree of judgment belonging to each individual being infinitely various: and though it has been urged that the care which a prudent man would take, is not an intelligible proposition as a rule of law, yet such has always been the rule adopted in cases of bailment, as laid down in Coggs v. Barnard.

The objective test could be applied outside bailment and contract:

The care taken by a prudent man has always been the rule laid down; and as to the supposed difficulty of applying it, a jury has always been able to say, whether, taking that rule as their guide, there has been negligence on the occasion in question.

Instead, therefore, of saying that the liability for negligence should be co-extensive with the judgment of each individual, which would be as variable as the length of the foot of each individual, we ought rather to adhere to the rule which requires in all cases a regard to caution such as a man of ordinary prudence would observe.

Vaughan J drew on the ship-master cases to hold that the gross negligence/ordinary prudence test provided a general standard of care.[61] This case adum-

[1892] AC 201, 219, Lord Herschell stated that *Gill v Cubitt* was not overruled but had been superseded or sidestepped by later doctrine.

[58] (1837) 3 Bing NC 468; 132 ER 490 (CP).

[59] Eg, *Crook v Jadis* 5 B & Ad 910; 110 ER 1028 (Taunton and Patteson JJ).

[60] (1837) 3 Bing NC 468, 474–6; 132 ER 490, 493–494.

[61] *Vaughan v Menlove* (n 60 above) 477; 494.

brates *Donoghue v Stevenson* and the emergence of modern negligence law a century later.

## F PRUDENCE IN TRUST DELEGATION AND MANAGEMENT

Late seventeenth and eighteenth century trust authorities tended to require gross negligence betokening fraud, the *culpa lata* standard of care,[62] but in the nineteenth century the standard of *culpa levis in concreto*, the habitual standard of the trustee, begins to assert itself, often clothed in the language of the prudent man.[63] But this normative construct is treated purely as a standard of care for due trust management, with the requirement of care being auxiliary to a primary trust duty such as investment; prudence was not a head of trust duty in itself. In 1914 in *Nocton v Lord Ashburton*, Lord Dunedin analysed this idea of overlap of concurrent actions from a historical perspective:

> Now, whenever we come to the idea of breach of duty we see how nearly the domains of law and equity approach, or perhaps, more strictly speaking, overlap. Take the word negligence—the culpa of the Roman jurists. There can be no negligence unless there is a duty. That duty may arise in many ways. There are certain duties which all owe to the world at large; alterum non lædere is one. So the man who leaves the loaded gun in a public place is liable for the accident ensuing, though it is not he that pulls the trigger. The common law gives a remedy. Then there are duties which arise from contract, of which the solicitor's position gives an example—spondet peritiam artis—he contracts to be professionally qualified and to be careful. Here again the common law will give an action for negligence. And then there are the duties which arise from a relationship without the intervention of contract in the ordinary sense of the term, such as the duties of a trustee to his cestui que trust or of a guardian to his ward. It is in this latter class of cases that equity has been peculiarly dominant, not, I take it, from any scientific distinction between the classes of duty existing and the breaches thereof, but simply because in certain cases where common justice demanded a remedy, the common law had none forthcoming, and the common law (though there is no harder lesson for the stranger jurist to learn) began with the remedy and ended with the right.[64]

[62] *Hussey v Markham* (1676) Rep t Finch 258; 23 ER 142 (decree that trustee is "Not to be chargeable with any Money, but what he, or others by his Order, shall actually receive; and not to be charged with any Loss in putting out Money at Interest, or for Money raised out of the Estate without his wilful Negligence or Default"); *Moore v Bennett* (1678) 2 Ch Cas 246; 22 ER 928 ("the Purchaser . . . shall be presumed cognisant of [the factual implications of a deed]; for it is crassa negligentia, that he sought not after it"); *Charitable Corporation v Sutton* (1742) 2 Atk 400, 405–406; 26 ER 642, 644–655 ("gross non-attendance" as a breach of the "fidelity and reasonable diligence" required of a trustee); *Harden v Parsons* (1758) 1 Eden 145, 148–149; 28 ER 639, 641 ("gross negligence" is not to be measured by a particular man's "habitual timidity about money matters" but by what "other prudent men do").

[63] *Caffrey v Darby* (1801) 6 Ves 488; 31 ER 1159; *Massey v Banner* (1819) 4 Madd 413; 56 ER 757; (1820) 1 J & W 241; 37 ER 367; *Moyle v Moyle* (1831) 2 Russ & M 710, 715; 39 ER 565, 567; *Clough v Bond* (1838) 3 My & Cr 490, 497; 40 ER 1016, 1018 (Lord Cottenham); *Munch v Cockerell* (1840) 5 My & Cr 178, 214; 41 ER 338, 352; *Mendes v Guedalla* (1862) 2 J & H 259, 277; 70 ER 1054, 1061 (Page-Wood VC. Cf Ibbetson "Law of Business Rome" above, 103–105.

[64] [1914] AC 932 (HL) 964.

This analysis allows that there can be a negligent breach of an antecedent trust duty; the correct question for the court is first to identify the requirements of the trust duty (to appoint, to invest, to delegate safely etc.), and then determine the appropriate standard of negligence.[65]

The main arena where the prudent man served to fix standards of liability was as a test for permissible delegation of trust functions. The basic rule was that trustees could not delegate performance of the trust; but it was obviously so inconvenient or even impossible to uphold this rule that delegation became permissible where held to be "necessary," which came to mean "reasonable."[66] The authorities up to the time of the Judicature Act were remarkably unclear as to which standard of care to apply where a trustee had delegated trust business to an agent and the delegation went wrong. Some authorities could be quite permissive; in *Jones v Lewis*[67] it was stated that a trustee who showed the same care that he would show for his own affairs (ie, the *culpa levis in concreto* and *diligentia quam suis rebus* standard) was not liable for the criminal fraud of his employee. In *Giblin v M'Mullen*[68] the Privy Council approved of the rule that employers were not liable, vicariously or otherwise, for the fraudulent acts of agents or employees because they were then not acting within the scope of their employment; or as the Massachusetts court in *Foster* et al *Executors v The Essex Bank*,[69] put it:

> the Bank was no more answerable for their [employees'] act than it would have been if they had stolen the Pocket-book of any person who might have laid it upon the desk while he was transacting some business at the Bank.

[65] This point is blurred by Viscount Haldane LC in his speech concerning fiduciary liability in *Nocton* [1914] AC 932 (HL) 956–7, where he states:

> There was a time when in cases of liability for breach of a legal duty of this kind [a solicitor's duty of care and skill] the Court of Chancery appears to have exercised a concurrent jurisdiction. That was not remarkable, having regard to the defective character of legal remedies in those days. But later on, after the action of assumpsit had become fully developed, I think it probable that a demurrer for want of equity would always have lain to a bill which did no more than seek to enforce a claim for damages for negligence against a solicitor.

But Viscount Haldane also implied that a concurrent jurisdiction to try negligence in equity as a species of equitable fraud still existed:

> [S]ince the Judicature Act any branch of the Court may give both [legal and equitable] kinds of relief, and can treat what is alleged either as a case of negligence at common law or as one of breach of fiduciary duty.

For modern statements of the nature of concurrent tort-equity liability see *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 205 (Lord Browne-Wilkinson (HL); *Bristol & West Building Society v Mothew (t/a Stapley & Co)* [1998] Ch 1, 16–18; [1996] 4 All ER 698, 710–711 (Millett LJ (CA); see further L Hoyano "The Flight to the Fiduciary Haven" in P Birks ed *Privacy and Loyalty* (OUP Oxford 1997) 169.

[66] *Ex parte Belchier; ex parte Parsons* (1754) Ambler 218; 27 ER 144; SC *Belchier v Parsons* (1754) 1 Kenyon 38; 96 ER 980 (Ch) (the latter much the better report); see also *Knight v Lord Plimouth* (1747) 3 Atk 480; 26 ER 1076 (delegation of receivership).

[67] (1751) 2 Ves Sen 241; 28 ER 155.

[68] [1869] 5 Moo NS 434; 16 ER 578 (PC); see also *Cheshire v Bailey* [1905] 1 KB 237.

[69] (1835) 17 Mass Reps 478.

This doctrine seems to have been applied both to gratuitous custody and to transactions where the custodian was remunerated. A typical case was *Re Bird; Oriental Commercial Bank v Savin*,[70] where an executor entrusted the collection of an estate debt to a solicitor, who then absconded with the money. Bacon VC relieved the executor of liability on the basis that he had done "just what any prudent man would think himself safe in doing," acting in the ordinary course of business, and employing the testatrix's solicitor who had been of good repute, though the judge felt unease about moving the entire loss to the beneficiaries. In *Job v Job*[71] Jessel MR held that the legal rule holding an executor liable from receipt was trumped after 1875 by the equitable rule holding that "an executor or administrator is in the position of a gratuitous bailee, who cannot he charged with the loss of his testator's assets without wilful default." In contrast to these pro-trustee decisions, Romilly MR waged a campaign from 1865 to make trustees strictly liable for delegates' misfeasances. In *Bostock v Floyer*[72] he held that a trustee employing a solicitor who criminally defrauded the trust was strictly liable for the loss. Romilly MR thought the case "too clear for argument"; and he gave little enough argument, asserting: "This is simply the case of a person employing his servant to do an act, and the servant deceiving him; and any loss so occasioned must fall on the employer, and not on the cestui que trust." In *Sutton v Wilders*[73] Romilly MR held a trustee lending to a mortgagor liable for employing the mortgagor's fraudulent solicitor, especially since a trustee had to take special precautions in order to reasonably employ a solicitor with conflicts of interest; again, he stated bluntly that frauds should fall on trustees not cestuis. In *Hopgood v Parkin*,[74] where a solicitor employed by trustees negligently failed to check an investment property for incumbrances and thereby caused loss to the trust, the same judge enlarged on the strict liability theory:

> It is true that his [the solicitor's] conduct is not theirs [the trustees']; but he is appointed by them, he is their agent for the management of the affairs of the trust, and if he misconducts himself through ignorance or negligence, or wilfully, he is answerable to the trustees, and they cannot, in my opinion, throw any of the loss thereby occasioned on their cestuis que trust . . . the trustees are bound to employ competent persons, and if they do not the loss must fall on them . . . it is exactly the same if it be done by the trustees themselves personally or by an incompetent or negligent agent. They must, therefore, bear the loss, and not the cestuis que trust, whom they were appointed to protect.

Another source of ideas was agency, where again American authorities provided important conceptualizations of the issues. In *Swinfen v Lord Chelmsford*[75] counsel argued:

[70] (1873) LR 16 Eq 203 (VC).
[71] [1877] 6 Ch D 562, 564.
[72] (1865) LR 1 Eq 26.
[73] (1871) LR 12 Eq 373.
[74] (1870) 11 Eq 74, 78–9.
[75] (1860) 5 H & N 890, 902–903; 157 ER 1436, 1441–1442.

In Story on Bailments, sect. 182, p. 203, 5th ed. it is said: “Dr. Paley, in his Treatise on Moral Philosophy (bk. 3, pt. 1, c. 12), has, with his usual practical good sense, put the case of mandates upon a reasonable ground. ‘Whoever,’ says he, undertakes another man’s business, makes it his own; that is, promises to employ upon it the same care, attention, and diligence that he would do if actually his own; for he knows that the business is committed to him with that expectation, and he promises no more than this.” Again, in sect. 182 a. it is said, that if a mandatory, who acts gratuitously, “has the qualifications necessary for the discharge of the ordinary duties of the trust which he undertakes, and he fairly exercises them, he will not be responsible for any errors of conduct or action into which a man of ordinary prudence might have fallen.” Even if a counsel is in the position of an agent, he may shew that what he has done has been from an unexpected or unforeseen emergency, to which the instructions or orders did not or could not apply; or, if they did apply, that he was compelled to act in order to prevent a greater loss, or absolute ruin, to his principal: “Story on Agency, sect. 237, p. 299, 4th ed.

The conflicting approaches to the delegation standard of care were given some resolution in *Speight v Gaunt* in 1883. Gaunt was trustee of a family settlement set up in the will of a Yorkshire textiles manufacturer named Speight.[76] Gaunt was also a local textiles manufacturer who had no professional investment expertise, but who accepted the trust out of friendship with the testator and his family. The trusteeship had landed him in trouble three years earlier, when his co-trustee embezzled from the trust fund; Gaunt temporarily saved him by extending him finance through purchase of his wool stock. Upon eventual insolvency, the creditors of the co-trustee sued Gaunt for creating a fraudulent preference, but Gaunt was absolved.[77] The case suggests that trustees such as Gaunt acted informally and without much attention to legal niceties.

Gaunt was instructed by the beneficiaries to invest £15,250, the bulk of the assets of the testamentary fund, in local government debentures by buying stock at three regional stock exchanges. To carry out these instructions, Gaunt selected a stockbroker, Cooke, on the informal suggestion of the beneficiaries, not knowing that Cooke was nearly insolvent. Cooke presented Gaunt with a forged bought note as evidence that he had procured the securities,[78] and Gaunt accordingly paid the trust funds over by cheque, without enquiring why no account date appeared on the note, or whether the stock had been bought directly from the corporations or through a stock exchange. Cooke promptly applied the money to his debts and vanished. The beneficiaries sued Gaunt for breach of his fiduciary duty to preserve the assets, alleging imprudence on his part in choosing and trusting a dishonest agent, and failing to enquire into the veracity of the bought note before tendering payment. No-one imputed dishonesty or even foolishness to Gaunt; only a possible lack of prudent judgement.

[76] *Speight v Gaunt* (1883) 22 Ch D 727 (CA), affirmed (1883) 9 App Cas 1 (HL).
[77] *Ex parte Stubbs; In re Wilkinson* (1880) 17 Ch D 58.
[78] There was much extant law on liability for losses caused by forgery which was not entered into by the court.

Bacon VC found Gaunt liable, applying the following standard:

> [A] trustee who takes another man's money into his hands is bound, whatever other duties he may have to discharge, to take care that the money shall be preserved, and not to deal with it or to do anything with it which a prudent and reasonable man would not do with his own money.[79]

Bacon V-C held it was not a reasonable custom of commercial men to pay a broker in cash for securities not yet executed, notwithstanding that this was shown to be the common practice. Reason and foresight provided independent tests for the lawfulness of commercial practice, and the courts were not bound to follow an existing custom judged to be dangerous and wrongful. The rule that trustees may not take any appreciable risks with trust monies was based on a classical Chancery policy of prophylaxis, of prevention rather than cure where monitoring of an agent and detection of wrongdoing is difficult:

> [T]he rule of law not only is unquestionable, but . . . it is founded on absolute and distinct truth and justice, and to relax it in the slightest degree might give occasion to the committal of fraud such as might easily be imagined, for trustees have been known to exist who would not hesitate to misappropriate trust funds, and it is not impossible that brokers might be found . . . who would assist in the spoliation of a trust fund.[80]

Trustee liability for loss of assets through delegation was therefore to be the standard imposed by equity against the grain of business practice, even though this drove the Vice-Chancellor "very reluctantly and with great pain to myself—if I have a right to say so, for I ought not to feel pain as I have only to administer the law—to say under pressure of the law that Mr. Gaunt is compellable by law to . . . make good the £15,275."[81] Bacon V-C followed the line of authority created by Romilly MR around 1870 in so holding the trustee personally liable for defaults of his agent.[82] The underpinning idea of his judgment was that defaults by a trustee's delegate must result in liability to the trustee, or else the trustee might not take due care to monitor the risks incurred by entrusting duties to his agents. More broadly, Equity applied norms to the market; it did not accept the practices of the market as it found them.

The Court of Appeal was not persuaded by the Vice-Chancellor, and reversed the decision in Gaunt's favour. Jessel MR applied a standard somewhere between *culpa levis in abstracto* and *culpa levis in concreto*:

> [W]hat is the liability of a trustee who undertakes an office which requires him to make an investment on behalf of his *cestui que trust* [?] It seems to me that on general principles a trustee ought to conduct the business of the trust in the same manner that an ordinary prudent man of business would conduct his own, and that beyond that there

[79] (1883) 22 Ch D 727 at 736.
[80] *Speight v Gaunt* (n 79 above) 738.
[81] *Speight v Gaunt* (n 79 above) 738–739.
[82] *Bostock v Floyer* (1865) LR 1 Eq 26; *Hopgood v Parkin* (1870) LR 11 Eq 74; *Sutton v Wilders* (1871) LR 12 Eq 373, discussed above at text accompanying nn 72–74.

is no liability or obligation on the trustee. In other words, a trustee is not bound because he is a trustee to conduct business in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It never could be reasonable to make a trustee adopt further and better precautions than an ordinary prudent man of business would adopt, or to conduct the business in any other way. If it were otherwise, no one would be trustee at all. He is not paid for it. He says, "I take all reasonable precautions and all the precautions which are deemed reasonable by prudent men of business and beyond that I am not required to go."[83]

Because it was the prevalent commercial practice to entrust brokers with purchase money prior to execution of securities, and because there was nothing to warn Gaunt that the broker he had selected was not honest, there was no breach of the requisite standard in the case before the court.

Jessel MR was careful to repudiate Bacon V-C's standard of external morality as the metric of trust obligation:

I think it is the duty of the Court in these cases where there is a question of nicety as to the construction or otherwise to lean to the side of the honest trustee, and not to be anxious to find fine and extraordinary reasons for fixing him with any liability upon the contract. You are to endeavour . . . as far as possible, having regard to the whole transaction, to avoid making an honest man who is not paid for the performance of an unthankful office liable for the failure of other people from whom he receives no benefit. I think that is the view which has been taken by modern Judges, and some of the older cases in which a different view has been taken would now be repudiated with indignation.[84]

To reach his position, Jessel MR quoted extensively from the judgment of Lord Hardwicke LC in the case of *Ex parte Belchier* in 1754.[85] There a trustee, Mrs Parsons, was instructed to sell a load of tobacco, and entrusted it to a broker for sale by auction. The broker sold the goods and received the money, but then died insolvent, and the sale money was lost in the bankruptcy. Lord Hardwicke relieved the trustee of liability, stating the following doctrine:

This court has laid down a rule with regard to the transactions of assignees, and more so of trustees, so as not to strike a terror into mankind acting for the benefit of others, and not for their own. . . . But where trustees act by other hands, either from necessity or conformably to the common usage of mankind, they are not answerable for losses.

Jessel MR glossed Lord Hardwicke's doctrine as follows:

[They are not answerable] where they act by other hands and properly choose the hand by which they act. Now what is meant by "either by necessity or conformably to the common usage of mankind"? It means where in the ordinary course of business transactions an agent is employed. A gentleman, for instance, who has rents to collect as a rule employs a rent collector. He might go around himself and collect them, but he does not do so. It is the common usage of mankind in such a case to employ an agent to do it. So a man who buys stock on the Stock Exchange employs a stockbroker, and there it is

83 *Speight v Gaunt* (n 79 above) 739–740.
84 Ibid 746.
85 *Ex parte Belchier* (1754) Amb 218; 27 ER 144.

absolutely necessary for him to do so; he cannot buy himself, but even if he could it is usual to employ a stockbroker.[86]

In Lord Hardwicke's judgment in *Belchier* two justifications were listed allowing for trustee delegation of functions to an agent: "Moral necessity, [and] from the usage of mankind. If a trustee acts as prudently for the trust as for herself and according to the usage of business."[87] The trusting of agents with trust money may not be strictly necessary, but will not be actionable "because the persons acted in the usual method of business." This test mixed individual and general objective standards. Where trust property was to be sold, it was asking too much that the trustee herself should sell the goods and receive and transfer the monies raised. A broker or banker could be given that role: "she [that is, the trustee], might have taken security, but to do that on every occasion would tend greatly to the hindrance of business." Lord Hardwicke's delegation standard based on "necessity" was affirmed by Jessel MR in *Speight*, and held to explain not just the rules for delegation to brokers, but to cover the principles of fiduciary delegation completely and indeed to establish the general duties of trustees and fiduciaries in the modern law.[88]

Jessel MR's judgment was followed by Lindley LJ, who stressed that any stricter form of liability for trustees who reasonably employ agents "would make it impossible for any man to have anything to do with a trust." He expressly overruled the strict liability rulings made by Romilly MR.[89] Bowen LJ stressed the economic necessity for a hierarchy of agents in business, noting that in contract agents in practise sub-delegated functions to their own agents. Delegation of trust functions was reasonable if that was the norm of the particular business, which was perhaps a mildly circular definition.[90]

In the House of Lords Lord Selborne LC held that the prima facie rule was that trustees could not delegate the execution of the trust or make over custody of trust funds or assets to agents without incurring strict liability;[91] but this rule

[86] (1883) 22 Ch D 727 at 741–743.

[87] *Ex parte Belchier* (1754) Amb 218; 27 ER 144.

[88] Jessel MR also cited *Clough v Bond* (1838) 3 My & Cr 490, 496–497; 40 ER 1016, 1018 (Lord Cottenham), where it was stated that a personal representative "is not liable, upon a proper investment in the 3 per cents, for loss occasioned by the fluctuations of that fund . . . but he is for the fluctuations of any unauthorised . . . fund. So, when the loss arises from the dishonesty or failure of any one to whom the possession of part of the estate has been entrusted. Necessity, which includes the regular course of business in administering the property, will, in equity, exonerate the personal representative. But if, without such necessity, he be instrumental in giving to the person failing possession of any part of the property, he will be liable". To like effect Jessel MR cited the decisions in *Joy v Campbell* (1829) 1 Sch & Lef 328; SC 3 Bligh NS 110; 4 ER 1280; and *Bacon v Bacon* (1800) 5 Ves 331; 31 ER 614, also concerning liability and discharge of co-executors. Interestingly the line of authority from *Belchier* was not mentioned in any of these cases.

[89] *Speight v Gaunt* (1883) 22 Ch D 727, 762.

[90] *Speight v Gaunt* (n 89 above) 762–3.

[91] Cf *Turner v Corney* (1841) 5 Beav 515 at 517; 49 ER 677 (Lord Langdale MR): "Trustees who take on themselves the management of trust property for the benefit of others have no right to shift their duty on other persons; and if they employ an agent, they remain subject to the responsibility towards their *cestuis que trust*, for whom they have undertaken the duty".

could be displaced by necessity. In contrast, Lord Blackburn delivered a long and considered opinion, mentioning no authority save *Belchier*,[92] in which he was concerned to justify the fullest possible power of delegation without liability. He began by observing the voluntary nature of Gaunt's trusteeship:

> The children of the testator [Speight] were all minors, and Mr. Gaunt accepted the trust, which seems to have been a troublesome one, out of regard to his friend's family. It was perfectly gratuitous on his part. I do not think this prevented it from being his duty, since he accepted the trust, to exercise proper care about its execution, nor prevented his being responsible for any loss sustained in consequence of his neglecting to do so. But I think where a person is to be remunerated for what he does, he ought not to accept the employment unless he has a competent knowledge and skill in the business he is to transact, and may properly be held liable if he proves deficient in either. I do not think that a person requested gratuitously to accept a trust, involving in it incidentally the conversion of investments into money and the reinvestment of the money, is under any obligation to have more knowledge or skill as to the business of conver[sion] . . . than that which the testator knew him to possess when he selected him as his trustee. The fact that Mr. Gaunt had no special knowledge on the subject furnished an additional reason why, besides using all the knowledge and skill he had, he should employ a stockbroker; perhaps he might be excused if he was deceived . . . when a man more conversant with that business would not have been deceived.[93]

Lord Blackburn followed *Belchier* to hold that delegation is permitted according to a usual course of business, "though it may be such that there is some risk that the property may be lost by the dishonesty or insolvency of an agent employed."[94] It was better for market pressures to regulate conduct here than legal rules:

> The transactions of life could not be carried on without some confidence being bestowed. When the transaction consists in a sale where the vendor is entitled to keep his hold on the property till he receives the money, and the purchaser is entitled to keep his money till he gets the property, it would be in all cases inconvenient if the vendor and purchaser were required to meet and personally exchange the one for the other; when the parties are, as is very often the case, living remote from each other, it would be physically impossible.
>
> Men of business practically ascertain how much confidence may be safely bestowed, or rather whether the inconvenience and hampering of trade which is avoided by this confidence is too heavy a premium for insurance against the risk thus incurred. When a loss such as that which occurred in *Ex parte Belchier*[95] occurs from having bestowed such confidence, they doubtless re-consider all this; and when a new practice, such as that of making bankers' cheques payable to order and crossing them arises, as it has done within living memory, no doubt it is made use of in many cases to avoid incurring that risk,

92 *Speight v Gaunt* (1883) 9 App Cas 1 at 15–28.
93 Ibid 17.
94 Ibid 19.
95 (1754) Amb 218; 27 ER 144.

which was formally practically inevitable. So that what was at one time the usual course, may at another time be no longer usual.

Judges and lawyers who see brought before them the cases in which losses have been incurred, and do not see the infinitely more numerous cases in which expense and trouble and inconvenience are avoided, are apt to think men of business rash. I think that the principle which Lord Hardwicke lays down is that, while the course is usual, a trustee is not to be blamed if he honestly, and without knowing anything that makes it exceptionally risky in his case, pursues that usual course. . . . [T]his is founded on principle. It would be both unreasonable and inexpedient to make a trustee responsible for not being more prudent than ordinary men of business are.

Lord Blackburn then reviewed best and worst practice in the London and provincial stock exchanges,[96] and concluded that the trustee Gaunt's behaviour in trusting his broker to settle was usual and hence reasonable.

Only Lord Fitzgerald doubted the consensus of the appellate judges; he accepted the legal tests derived from *Belchier*, but found that the duty of diligence had not been met by Gaunt, who had failed to make the inquiries that a reasonably prudent man would have made about his own money.

## G A GENERAL STANDARD OR A DELEGATION STANDARD?

*Speight v Gaunt* affirms an objective standard, that of the ordinary prudent man of business. Yet the manner in which the judges expressed their concern not to burden the unremunerated or unskilled trustee suggests a subjective element in the implementation of the standard: what could reasonably be expected from this particular trustee, or trustees with these particular qualities? As in the gross negligence tests of the previous century, objective and subjective standards are subtly intertwined. It is also significant, with the exception of brief mention by Lord Blackburn, that no different, stricter test was proposed for the remunerated or professional trustee, though by 1883 there were many examples of these, such as solicitors acting on retainers and handling clients' investment affairs. Older authorities stated explicitly that a trust was an honorary office, not to be taken up for mercenary reasons.[97] Formally any payment to the trustee authorized in the trust instrument counted as a gift from the beneficiaries at law;[98] though equity later developed an inherent jurisdiction to award reasonable

[96] For contemporary stock exchange practice see RB Ferguson "Commercial Expectations and the Guarantee of the Law: Sales Transactions in Mid-Nineteenth Century England" in GR Rubin and D Sugarman (eds) *Law, Economy and Society, 1750–1914: Essays in the History of English Law* (Professional Books Abingdon, 1984) 192–208; R Michie, *The London Stock Exchange: A History* (OUP Oxford 1999) chs 1 & 2.

[97] *Ayliffe v Murray* (1740) 2 Atk 58; 26 ER 433.

[98] *Ellison v Airey* (1748) 1 Ves Sen 11, 15; 27 ER 924, 927 (Lord Hardwicke LC); *Re White* [1898] 1 Ch 297, 299–300; *Re Duke of Norfolk's Settlement Trusts* [1982] Ch 61, 71–79 (Fox LJ; 80–88 (Brightman LJ); Law Commission, *Trustees' Powers and Duties* (Consultation Paper No. 146, 1997) 152–163.

remuneration at the suit of the trustee.[99] In a sense the trust of that era represented a type of gift economy in substance as well as form, where friends and families performed managerial services for each other at discretion, in the social expectation of receiving like benefits of trusteeship in due course.[100]

Though there were lacunae in the *Speight* doctrine, Jessel MR's judgment was immediately received into the canon of English equity jurisprudence as the classical test for trustee's duties.[101] In *Fry v Tapson*[102] it was stated that the case "did not lay down any new rule, but only illustrated a very old one, viz, that trustees acting according to the ordinary course of busines, and employing agents as a prudent man of business would do on his own behalf, are not liable for the default of an agent so employed."[103] But it was soon noted that the essential standard—to handle trust assets as an ordinary prudent businessman would handle his own—was problematic. The test requires the trustee to act as if he were dealing with his own money, when the whole point causing the difficulties is that he is controlling someone else's money as a fiduciary. He has far more information about, and control over, the asset than the beneficiary. He has a duty to protect and maximize the asset's value on behalf of someone else, but if he is an unremunerated trustee then he has no incentive to do well; and even if remunerated he may profit no further from successful performance. The classical "Massachusetts" standard of trustee duty, enunciated by Putnam J 50 years before *Speight* in the case of *Harvard College v Amory* and adopted through most of the United States in the mid-twentieth century, picked up the problem with generalized duties of reasonableness for trustees:

> All that can be required of a trustee to invest is, that he shall conduct himself faithfully and exercise a sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probable safety of the capital to be invested . . . Do what you will, the capital is at hazard.[104]

[99] *Re Duke of Norfolk's Settlement Trusts* [1982] Ch 61.

[100] On the operation of gift economies: M Mauss, *The Gift* (*Essai sur le don* 1925; I Cunnison (trans) Cohen & West London 1954); K Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (Beacon Press Boston 1944); M Godelier, *The Enigma of the Gift* (Polity Cambridge 1999); CA Gregory, *Gifts and Commodities* (Academic Press London 1982); A Offer "Between the Gift and the Market: The Economy of Regard" (1997) 50 Economic History Review 450; applications to law: JP Dawson, *Gifts and Promises* (Yale University Press New Haven 1980); Ibbetson, *Historical Introduction*, n 25 above, 3ff.

[101] *Re Brier* (1884) 26 Ch D 238; *Fry v Tapson* (1884) 28 Ch D 268; *Re Whiteley* (1886) 33 Ch D 347; *Learoyd v Whiteley* (1887) 12 App Cas 727; *Hallows v Lloyd* (1888) 39 Ch D 686; *Low v Bouverie* [1891] 3 Ch 82; *Jobson v Palmer* [1893] 1 Ch 71; *Re Vickery* [1931] 1 Ch 572; *Re Waterman's Will Trusts* [1952] All ER 1054; *Pilkington v Inland Revenue Commissioners* [1964] AC 612; *Elder's Trustee and Executor Company Limited v Higgins* (1963) 113 CLR 426 (HCA); *Re Lucking's Will Trusts* [1968] 1 WLR 866; *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515; *Cowan v Scargill* [1985] Ch 270.

[102] (1884) 28 Ch D 268.

[103] *Fry v Tapson* (n 102 above) 280 (Kay J).

[104] (1830) 9 Pick 446 at 461 (Mass).

The prudent man doctrine as enunciated in *Speight v Gaunt* was formulated on the assumption that no remuneration was provided for the trustee in the trust instrument proper; the judges seem to assume that unremunerated trusteeship is the norm. Such a non-contractual, unpriced, discretionary provision of services can be highly efficient, because it is self-policing, with low enforcement costs, and ease of re-negotiation. These are general features of markets for professional services; for example skilled lawyers, doctors and higher management likewise work in an environment of unpriced or casually priced exchange of services with strong discretions and low levels of monitoring.[105]

The decision of *Learoyd v Whiteley* in 1887 directly confronted the problem of setting the level of trust norms for altruistic management. In the Court of Appeal[106] Lindley LJ stated that "the duty of a trustee . . . is to take such a care as an ordinary prudent man would take if he were minded to make an investment for the benefit of people for whom he felt morally bound to provide." This influential test was rooted in a traditional, non-professional and familial concept of trust investment, though it is hard to decide the precise content of that standard. Lord Watson in *Learoyd* restated the *Speight* test in more cogent terms as follows:

> As a general rule the law requires of a trustee no higher degree of diligence in the execution of his office than a man of ordinary prudence would exercise in the management of his own private affairs. Yet he is not allowed the same discretion in investing the moneys of the trust as if he were a person sui juris dealing with his own estate. Business men of ordinary prudence may, and frequently do, select investments which are more or less of a speculative character; but it is the duty of a trustee to confine himself to the class of investments which are permitted by the trust, and likewise to avoid all investments of that class which are attended with hazard.[107]

Reasonable delegation was permitted provided the trustee retained a discretion over the investment policies of his agents.[108] In effect Lord Watson was propounding a "safe harbour" test for trust management, listing the types of permitted investment whereby a trustee could safely pay over the assets to others. He went on to list the typical range of "authorized investments" approved by equity—investments with a safety margin of one third of value for agricultural land, and one half for built land.

[105] Here I differ from the price-efficiency model of W Bishop and DD Prentice "Some Legal and Economic Aspects of Fiduciary Remuneration" (1983) 46 Modern L Rev 289. See further FH Easterbrook and DR Fischel "The Corporate Contract" in LA Bebchuk (ed) *Corporate Law and Economic Analysis* (Cambridge 1990) 182–215.

[106] *Re Whiteley* (1886) 33 Ch D 347, 355.

[107] (1887) 12 App Cas 727 at 733.

[108] *Learoyd v Whiteley* (1887) 12 App Cas 727 at 734. The case law dealing with reasonable control of delegation by trustees is voluminous; see GH Jones "Delegation By Trustees—A Reappraisal" (1959) 22 Modern L Rev 381; Law Commission, *Trustees' Powers and Duties*, 9–132. A sample of delegation cases: *In re Earl of Litchfield* (1737) 1 Atk 87; 26 ER 57; *Matthews v Brise* (1843) 6 Beav 239; 49 ER 817; *Ghost v Waller* (1846) 9 Beav 497; 50 ER 435; *Rowland v Witherden* (1851) 3 McN & G 568; 42 ER 379; *Fry v Tapson* (1884) 28 Ch D 268; *Re Weall* (1889) 42 Ch D 674; *Re Gasquoine* [1894] 1 Ch 470; *Green v Whitehead* [1930] 1 Ch 38.

## H THE PRUDENT TRUSTEE IN MODERN MARKETS

Lord Watson's *dirigiste* approach to permitted trust investments and delegations built on a strong foundation in older equity jurisprudence. For much of the eighteenth and nineteenth centuries stock futures were formally illegal; investment in company stocks[109] and even mortgages[110] were long regarded as beyond the pale by courts of equity; only gilts or local and central government issues in addition to land purchase were acceptable. Trust legislation codified these restrictions and forced trust investments into holdings benefiting governmental and landed capital.[111] With these restrictive investment norms in place, trust capital tended to underperform compared to the security market throughout the nineteenth and most of the twentieth centuries. The courts of equity clung to their conservative favouring of land and bond investments through the long agricultural depression from 1870, and relieved trustees of liability for investment decisions even when trust assets were diminished by falling land prices and inflation. The law gradually accepted that trustees were obligated to maximize financial returns to trust funds as well as preserve the capital, and developed doctrines of impartiality between capital growth and income returns. But there was little legal recognition of the emerging practice of portfolio investment, which allowed trustees to invest in higher asset-specific risks and rewards across a diversified range of investments. Trust instruments increasingly came to include clauses authorising more commercially aggressive investment, thus "contracting out" of the conservative equitable and statutory investment limitations.

The chief response of the law to changing trust investment practice has been to pass permissive legislation adopting certain common clauses found in professional trust and instruments and company articles, creating a piecemeal set of default rules that were difficult to follow and interpret. The main innovations from the nineteenth century were twofold: wide delegation of trust functions was permitted provided it was done in "good faith"; and vicarious liability for losses caused by agents was restricted to those losses caused by the trustee's "wilful default."[112] Judges struggled with the differential subjective and objective tests contained in this rather obscure legislation, and ultimately the two tests were collapsed into a strongly subjective test, requiring fraud or recklessness to establish liability.[113] This rediscovery of *culpa lata* as the dominant stan-

[109] *Adye v Feuilleteau* (1783) 1 Cox 24; 29 ER 1045.

[110] *Cator v Cooley, ex parte Cathrope* (1785) 1 Cox 182; 29 ER 1119; *Raby v Ridehalgh* (1855) 7 De GM & G 104; 44 ER 41.

[111] G Moffat et al, *Trust Law: Text and Materials* (3rd edn Butterworths London 1999) ch 10.

[112] Trustee Act 1925 ss 23 and 30, derived from Acts of 1859 and 1893, codifying common trust clauses.

[113] Cf *Fry v Tapson* (1884) 28 Ch D 268; *Re City Equitable Fire Insurance Co* [1925] Ch 407 (Romer J; *Re Trusts of Leeds City Brewery Ltd's Deed* [1925] Ch 532; *Re Vickery* [1931] 1 Ch 572; *Steel v Wellcome Custodian Trustees Ltd* [1988] 1 WLR 167 at 174 (Hoffmann J). This approach was approved by Millett LJ in *Armitage v Nurse* [1998] Ch 241, 252; [1997] 2 All ER 705, 711–712.

dard for trustee performance attracted a degree of criticism,[114] and some judges reacted by insinuating *culpa levis* standards back into trust law.[115] One approach was to use the tortious notion of the reasonable professional to bring standards back up.[116] But other cases continued to emphasize subjective good faith as a defence even where trustee performance falls below a common standard.[117] Recent decisions in the Court of Appeal have finessed the problem by holding that the trustee's duty of care, whilst inherent to his or her status as trustee, nonetheless sounds as a duty in tort rather than a fiduciary obligation. Millett LJ expressed this idea pungently in *Bristol and West Building Society v Mothew*:

> Breach of fiduciary obligation, therefore, connotes disloyalty or infidelity. Mere incompetence is not enough. A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty.[118]

Such breach of the trustee's duty of care was therefore to be remedied according to common law not equitable procedures and remedies. In other words there can be a breach of a trustee's duty of care which is not a breach of the specifically equitable obligation of good conscience and loyalty, that is, the requirements to avoid fraud, dishonesty, conflict of interest. But a breach of the duty of care which is both advertent ("wilful default") and made dishonestly, that is not with the beneficiary's best interests in view, becomes fraud on the equity side as well as breach of the duty of care at law.[119]

The splitting of equitable duties of care from fiduciary obligations is a well-founded idea, but it carries its own dangers. For example, the tort-flavoured duty of care is now subject to common-law rules of contributory negligence; yet it is far from clear that contributory negligence is appropriate even in arms-length

[114] WS Holdsworth, (1931) 47 LQR 463; H Potter, (1931) 47 LQR 331; Jones "Delegation" 381–385; JE Stannard "Wilful Default" [1979] Conv (NS) 345; Law Commission, *Trustee's Powers and Duties*, n 98 above, 60–77.

[115] See eg, *Re Lucking's Will Trusts* [1967] 3 All ER 726 (Cross J).

[116] See eg, *Bartlett v Barclays Bank Trust Co Ltd* [1980] Ch 515 at 531–534 (Brightman J).

[117] *Nestle v National Westminster Bank Plc* [1994] 1 All ER 118; and note unreported judgment of 29 June 1988 (Hoffmann J in EH Burn, *Maudsley and Burn's Trusts and Trustees* (5th edn Butterworths London 1996) 719. In *Swindle v Harrison* (1997) 4 All ER 705 the Court of Appeal emphasizes a requirement of lack of subjective good faith as a prerequisite to the granting of full equitable remedies for breach of the core fiduciary duties of loyalty. It would be fair to say that the introduction of subjective fraud and *culpa lata* measures for the trustee's loyalty duties is highly controversial. Cf *Walker v Stones* [2001] QB 902, 937–941; *Royal Brunei Airways Sdn Bhd v Tan* [1995] 2 AC 378, 389–390.

[118] *Bristol & West Building Society v Mothew (t/a Stapley & Co)* [1998] Ch 1, 18.

[119] This model of the duty of care is set out by Millett LJ in *Bristol & West Building Society v Mothew (t/a Stapley & Co)* [1998] Ch 1, 16–18; [1996] 4 All ER 698, 710–712; and *Armitage v Nurse* [1998] Ch 241, 251; [1997] 2 All ER 705, 711–712 (CA), building on similar ideas expressed in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 205 (Lord Browne-Wilkinson), and *Permanent Building Society v Wheeler* (1994) 14 ACSR 109, 157 (Ipp J). See further *Swindle v Harrison* (1997) 4 All ER 705 (CA). The volume of commentary on these influential cases is growing fast; see particularly S Elliott "Restitutionary Compensatory Damages for Breach of Fiduciary Duty" (1998) 6 Restitution LR 135; S Worthington "Fiduciary Obligations: When is Self-Denial Obligatory?" [1999] CLJ 500; P Birks "The Content of Fiduciary Obligation" Lionel Cohen Lecture [2001] Israel L Rev.

contractual relationships, let alone in trusts.[120] The prophylactic pressures of equitable procedure and remedy as applied to the loyalty duties may have point even in the sphere of duty of care; the stringent rules of causation, for example, are designed to put deterrent pressure on the fiduciary to reach a high standard where proof of misfeasance may be difficult to gather.[121] Moreover, tort duties outside the core fiduciary duties of a trust may readily be excluded by indemnity and exemption clauses, yet it is not clear how procedural safeguards in the negotiation of these clauses can protect beneficiaries who commonly are not privy to the dealings at the time of constitution of the trust. In addition to these procedural difficulties, there will always be the problem of line drawing between duties of care and duties of loyalty—one of the key themes in the now-forgotten history of gross negligence that we have been observing. The House of Lords in *Henderson v Merrett Syndicates Ltd*[122] accepted that an assumption of duty could sound concurrently in both contract and tort, with tort duties of reasonable performance articulating and extending the contractual obligation. In like fashion, a tort-like duty to make reasonable efforts at careful performance can be seen to articulate what it means to be a loyal fiduciary devoted to the interests of beneficiaries. A striking expression of this idea is given by Kekewich J, writing of a grossly negligent corporate director:

> He is acquitted of dishonesty in the usual sense of the word. But in another sense he is not honest. It seems to me that a man who accepts such a trusteeship, and does nothing, . . . never asks for explanation, and accepts flimsy explanations, is dishonest.[123]

The next stage in the evolution of the trustee's duty of care will be the courts' response to the restatement of that duty in the Trustee Act 2000. The Law Commission which designed the legislation recommended liberalization and enhancement of trustee's powers, counterbalanced by a new objective duty of care for trust management. The new statutory duty relates *inter alia* to investment, acquisition of land, delegation and insurance of assets:

> Section 1.—(1) Whenever the duty . . . applies to a trustee, he must exercise such care and skill as is reasonable in the circumstances, having regard in particular-
>
> (a) to any special knowledge or experience that he has or holds himself out as having, and

[120] Compare *Vesta* [1989] AC 852 (CA) and *Astley v Austrust* (1999) 161 ALR 155; *Pilmer v Duke Group Ltd* [2001] HCA 31; cf Law Commission *Contributory Negligence as a Defence in Contract* (Working Paper No 114 HMSO London 1990; Law Com Report No 219 HMSO London 1993).

[121] These arguments are elaborated in J Getzler "Equitable Compensation and the Regulation of Fiduciary Relationships", in P Birks and F Rose (eds) *Restitution and Equity Volume One: Resulting Trusts and Equitable Compensation* (Mansfield London 2000) 235–257. Cf *Pilmer* (n 120 above).

[122] [1995] 2 AC 145, 193–194 (Lord Goff); 205 (Lord Browne-Wilkinson).

[123] *Re Second East Dulwich 745th Starr-Bowkett Building Society* (1889) 68 LJCh 196, 198 (Kekewich J. For modern articulations of this idea, see DM Phillips "The Commercial Culpability Scale" (1982) 92 Yale LJ 228; T Frankel "Fiduciary Law" (1983) 71 Calif LRev. 795; T Frankel "Fiduciary Duties as Default Rules" (1995) 74 Oregon LRev 1209–1277.

(b) if he acts as trustee in the course of a business or profession, to any special knowledge or experience that it is reasonable to expect of a person acting in the course of that kind of business or profession.

Again the statute provides a default rule only,[124] and this latest incarnation of *culpa levis in abstracto* is unlikely to be retained unmodified in professional trusts, in contrast to the mandatory duties of pension trustees.

## I CORPORATION AND TRUST

I will conclude with a set of speculations. The historically low standard of the trustees' duty of care, and the recent merger of this duty into common negligence, present challenges to trust lawyers striving to manage and control the shift of trust investment into professionalized financial markets. Restatement and clarification of the trustee's duty of care ultimately does amount to a fresh process of regulation of trustee conduct, and we may properly debate the most appropriate regulatory form.[125] One possible response would be to focus less on readily available contract-tort-equity models for controlling negligent performance of trust services, and instead revisit the age-old relationship of trust and corporation. A century ago Maitland[126] celebrated the widespread use of the trading trust as a surrogate for the limited-liability joint-stock corporation, both before and after the collapse of joint stock enterprise in 1720. Maitland highlighted the trust's advantages of privacy, informality, lack of bureaucracy and expense, and freedom from the heavy regulatory hand of the state. He also noted the affinity of the trust for English liberal pluralism, with the unincorporated association in trust form allowing freedom of religious association and worship. Modern historians have doubted Maitland's brilliant surmise of the utility of the trust for trading enterprise; in fact businessmen from the late eighteenth century needed corporate form and separate legal personality in order to organize modern industrial enterprise, and they sought and won free incorporation from the state.[127] But the private, unregulated trust was certainly not abandoned as a legal vehicle by all entrepreneurs; the trust remains the main business form of the financial investment industry, notably the pension industry. The legislatively entrenched division of legal and regulatory regime between companies and financial services only further emphasizes the survival and growth of the trust institution in capital markets.

[124] Trustee Act 2000 Schedule 1, 7: "The duty of care does not apply if or in so far as it appears from the trust instrument that the duty is not meant to apply".
[125] Cf Law Commission, *Trustees' Powers and Duties* (n 98 above) 96–97, disavowing any regulatory intent.
[126] FW Maitland "The Unincorporate Body" and "Trust and Corporation" in HD Hazeltine, G Lapsley and PH Winfield (eds), (CUP Cambridge 1936) 128, 141.
[127] R Harris, *Industrializing English Law: Entrepreneurship and Business Organization, 1720–1844* (CUP Cambridge 2000); T Alborn *Conceiving Companies: Joint-Stock Politics in Victorian England* (Routledge London 1998).

The deregulated trust for investment may be the City's version of the "Delaware effect" in America, whereby the state of the union with the most unregulated market for business managers attracts the most business. The Trustee Act 2000 certainly continues in this vein, as it seeks to empower trustees by enlarging their legal capacities and protections, balanced by some added requirements of consultation and information provision as the only real added control of trustee power. Other European states are now setting up civil law trusts by legislation; this might be represented as an attempt by those states to claim their share of the UK's enormous international financial business, and thereby move away from the continental system of internal capitalization and close, long-term bank partnership with enterprise. This foreign emulation of the English trust-governed capital markets contains some irony, as the Myners Report has recently thrown strong doubts on the rationality, accountability and efficiency of institutional trust investment in the UK.[127a]

The corporate constitution may provide a positive model for reform of trusts. Corporate directors are now subject to stringent regulation, with the law imposing duties of skill and care that are difficult to evade. The existence of legislation sanctioning incompetent corporate managers with disqualifications and personal liability for corporate insolvency adds to the regulatory pressure; and in addition there are disciplines applied by non-executory directors, shareholder democracy, and the relentless pressure of market valuation of company performance through trade in stocks and securities.[128] Trustees and fiduciaries handling large assets for reward are comparatively unregulated by comparison. They could be subjected to more of the disciplines and controls applied to company directors, including *inter alia* the directors' duties of care and skill. In other words, the larger trusts could well become more corporate, and attract a bespoke system of corporate governance. With the heightened reporting and monitoring procedures of the Pensions Act 1995 and (to a lesser degree) the Trustee Act 2000, the process of rationalizing and structuring trust management has already begun. The next Trustee Act could extend this rationalizing, regulating process to larger trusts that serve mainly commercial purposes.[129] We ought not continue to model the legal structure of the portfolio investment trust as if it were a private family arrangement, with duties of care tracing back to Rome's *bonus paterfamilias*.

[127a] P Myners *Institutional Investment in the United Kingdom: A Review* (HM Treasury London 2001).

[128] LS Sealy "The Director as Trustee" [1967] Camb LJ 83; LS Sealy "Fiduciary Obligations, Forty Years On" (1995) 9 JCL 37, 40, 51ff; E Ferran, *Corporate Law and Corporate Finance* (OUP Oxford 1999) 206–275; S Worthington "Corporate Governance: Remedying and Ratifying Directors' Breaches" (2000) 116 LQR 638, 651–656.

[129] Cf JH Langbein "The Secret Life of the Trust: The Trust as an Instrument of Commerce" (1997) Yale LJ 165.

# 3

# *Conflicts*

EDWIN SIMPSON

## A INTRODUCTION

SINCE THE PUBLICATION in 1977 of Finn's definitive study of the subject,[1] the law governing fiduciaries has continued to require sustained and wide-ranging attention. By 1991, in an essay on the commercial application of fiduciary principles, Finn was able to list five persistent questions.[2] First, what are the criteria for finding that a fiduciary relationship exists? Secondly, how and to what extent do fiduciary principles apply in commerce? Thirdly, how does fiduciary law regulate multi-function business and professional enterprises? Fourthly, what kinds of monetary compensation are available for breach of fiduciary duty? And fifthly, what role does fiduciary law have in regulating the actions of government? In turn, in 1996, Austin suggested that a sixth question needed to be added to the list, the issue of the *content* of fiduciary duties. He put the sixth question, or perhaps one had better say collection of questions, thus:

> Is the hallmark of a fiduciary relationship simply that one party owes a duty of loyalty to another, or are there separate fiduciary duties of care, disclosure, and (where relevant) strict adherence to the charter (such as an instrument or memorandum and articles of association) which constitutes the relationship? What precisely do we mean by "loyalty"? Does it extend beyond narrowly defined conflict and profit rules to encompass positive duties to act in the interests of the principal and in good faith?[3]

Finn had certainly not overlooked these questions. His initial approach had been to divide fiduciary obligations into eight categories;[4] including, perhaps most importantly, rules preventing "the conflict of duty and interest" (in this

[1] PD Finn *Fiduciary Obligations* (The Law Book Co Sydney 1977).
[2] PD Finn "Fiduciary Law and the Modern Commercial World" in E McEndrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (OUP Oxford 1992) 7.
[3] RP Austin "Moulding the Content of Fiduciary Duties" in AJ Oakley (ed) *Trends in Contemporary Trust Law* (OUP Oxford 1996) 153.
[4] Finn's full list ran as follows: undue influence, the misuse of property held in a fiduciary capacity, the misuse of information derived in confidence, purchases of property dealt with in a position of a confidential character, conflict of duty and interest, conflict of duty and duty, renewals of leases and purchases of reversions, and inflicting actual harm on an "employer's" business.

Chapter called the conflict rule), "the misuse of property held in a fiduciary capacity" (here called the profit rule), and "the purchasing" rule (here subdivided into the "self-" and "fair-dealing" rules[5]), each of which he regarded as a particular instance of a more general duty of good faith. Each example of that general duty, Finn argued, had its own policy objectives, each defined its own "fiduciary," and each exacted its own distinctive standard of acceptable behaviour from that fiduciary.[6] Such an analysis certainly has considerable descriptive force, but it has since been questioned whether it is necessarily the best approach to regard *all* duties imposed upon fiduciaries as being, in some special sense, "fiduciary." It may be more useful to distinguish the duties which are somehow distinctive of the fiduciary's lot from other duties—such as duties of care and skill—to which non-fiduciaries as well as fiduciaries are at times subject. Of course this, in turn, will only be useful if there is some means of *identifying* the genuinely fiduciary obligations; and this, it seems,[7] can be done by means of the allied notions of loyalty and prophylaxis. A rule designed to foster loyal behaviour will take effect not by *responding* to particular events, but by aiming to *discourage* a particular class of events from happening at all: it will be prophylactic rather than responsive, and so operate *pour encourager les autres*.[8]

Such a means of identifying genuinely fiduciary obligations points to those which are *proscriptive* in nature, and not to those positive obligations to which a fiduciary may also, in some circumstances, be subject.[9] It seems inevitably to direct attention first to the conflict and the profit rules; and then, although perhaps a little less obviously, towards the "self-" and "fair-dealing" rules. But it can do little to elucidate the relationships, if any, between these various rules. Although there can be no dispute that the conflict and profit rules have their origin in the old cases concerning the renewal of leases in favour of trustees,[10]

[5] Finn doubted any distinction between the self dealing and fair dealing rules: Finn (n 1 above) 185; and see text to n 57 below. For the effect of the two rules see the text to nn 48, 56 below.

[6] Finn (n 1 above) 78.

[7] Austin (n 3 above) proceeded by analysing a range (slightly different from Finn's) of "duties" imposed on fiduciaries—such as the requirement that a fiduciary's discretions must not be fettered and must be exercised for proper purposes (161), the requirement that trustees and company directors are absolutely liable for breach of duty if they fail to comply strictly with the terms of the "charter" of their relationship (the trust instrument or the memorandum and articles of association), (164–168), and the fiduciary's duty of care—to see whether they should be regarded as logically distinct from the, genuinely fiduciary, conflict and profit rules. His suggested analysis was that there is indeed something clearly distinctive about the conflict and profit rules, and that the distinctiveness is to be found in their prophylactic nature.

[8] Sir Peter Millett, "The Error in *Lister v Stubbs*", in P Birks (ed) *The Frontiers of Liability*, vol 1 (OUP Oxford 1994) 56.

[9] See the discussion of *Warman International Ltd v Dyer* (1995) 69 ALJR 362 in Austin (n 3 above) 154–156. Cf the Court of Appeal in *A.-G. v Blake* [1998] 2 WLR 805 (CA) 814 and Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1(CA)16: fiduciary duties are "those duties which are peculiar to fiduciaries and the breach of which attracts legal consequences differing from those consequent upon the breach of other duties."

[10] Text following n 20 below.

the extent to which one or more principles must be regarded as underlying the existing authorities is very far from settled.[11] Before examining the development of these various rules in a little more detail, a word must be said about two further contributions to the debate, emanating from the law of restitution.

It might be thought that legal rules designed to *discourage* particular events from taking place, rather than honed as responses to them, would be resistant to restitutionary analysis. But in 1968 Gareth Jones[12] argued that claims based upon a breach of the duty of loyalty should, in certain circumstances, be regarded as instances of those restitutionary claims in which the claimant seeks to recover a benefit acquired through the defendant's wrongful act: so-called "restitution for wrongs." In many cases Jones accepted that a prophylactic objective and one of reversing unjust enrichment would not conflict. But in some circumstances they might, where the fiduciary's enrichment could not be said to have been unjustly gained.[13] Jones suggested that there might, nevertheless, be circumstances where it would be necessary to punish the fiduciary, even where his enrichment could not be said to have been unjustly gained, but such a decision would be better informed if the various stages of orthodox restitutionary analysis were first thought through. A "purely" prophylactic response would then be revealed as the rule of public policy that it must be.

It would be wrong to disagree with any of this careful thinking. Where there has been actual wrongdoing, there is clearly an alternative analysis available (to that of fostering loyalty) by means of which legal intervention can be justified. That is not to say that the law must, of necessity, analyse the situation differently in such circumstances, for any rule intended to operate prophylactically (and so having the fostering of loyalty as its basis) will need to have remedial effects in any particular case where its deterrent effects have failed. Were it not to do so, then it would be unable ever to deter. And certainly Jones did not advocate what might be envisaged as the strongest possible restitutionary point of view, that the prophylactic rule ought to be *replaced* by one which could *only* be triggered by actual wrongdoing.

More recently,[14] Richard Nolan has argued that some of the conflict rules (unlike Austin,[15] he uses this phrase broadly) may be capable of being understood as reversals of unjust enrichment *by subtraction*, rather than as restitution founded upon *wrongdoing*. So, he argues, if a fiduciary purchases property

[11] For the relationship between the "self-" and "fair-dealing" rules, Megarry J in *Tito v Waddell (No. 2)* [1977] Ch 106, text to note 57 below. For the relationship between the conflict and profit rules, Deane J in *Chan v Zacharia* (1984) 53 ALR 417 (Aus HC) cited with approval in *Don King Productions Inc v Warren* [1999] 3 WLR 276, 320–321, and *Warman International Ltd v Dwyer* (1995) 128 ALR 201 (Aus HC).

[12] G Jones "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 LQR 472.

[13] The split decision of the House of Lords in *Phipps v Boardman* [1967] 2 AC46 (HL) was clearly much occupying minds.

[14] RC Nolan "Conflicts of Interest, Unjust Enrichment and Wrongdoing" in WR Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Oxford 1998) 87.

[15] See the end of the passage quoted in text to n 3 above.

from the principal at an undervalue, in breach of the "self-dealing" rule,[16] the liability of the defendant to make restitution is to be regarded as founded on a benefit indirectly subtracted from the claimant. Following Jones, Nolan does not argue that these rules are unconcerned with fostering loyalty *at all*: he describes the rules he analyses as having "evolved to control the conflicts of duty and interest,"[17] and states clearly that "the self-dealing rule exists to promote a fiduciary's loyalty to his principal."[18] But although such rules are accepted as existing to promote loyalty, they can also, it is said, be understood as instances of the reversal of unjust enrichment by subtraction, where the unjust factor is the lack of a fully informed consent to the impugned transaction from the principal.[19]

The breadth of the existing debates is readily apparent. Against that background, the focus of this Chapter was conveniently set by the subject of the colloquium at which it was delivered. In so far as consideration of the conflict rules was appropriate at all at a gathering to discuss breaches of trust, it certainly seemed proper to confine attention specifically to the ambit of such rules *as they apply to express trustees*. And there may be a virtue in such a limited focus, in that it might be hoped that matters would be clearest at the subject's core. One might expect that the conflict rule would, if anywhere, have been applied without particular difficulty, because applied with particular rigour, in the context of trusts and trustees.

## B THE DEVELOPMENT OF THE CONFLICT AND PROFIT RULES IN THE CONTEXT OF TRUSTEES

The correct way to express the, (to use Austin's words), "narrowly defined conflict and profit rules," so as to begin to tackle any relationship between them, is itself not straightforward. *Lewin on Trusts* has them (in reverse order) as follows:[20]

> The first is that a trustee, like other fiduciaries, is not in general allowed to retain a benefit acquired or profit made by him from the use of trust property or in the course of and by virtue of his trusteeship. The second rule is that a trustee, like other fiduciaries, is not allowed to place himself in a position where his personal interest, or interest in another fiduciary capacity, conflicts or possibly may conflict with his duty.

### 1 Early Developments

The early development of the two rules took place, of course, in cases concerned with the renewal of a lease by a trustee in his own name. The established

[16] For treatment of this rule in the specific context of trustees, see text from note 48.
[17] Nolan (n 14 above) 87.
[18] Nolan (n 14 above) 93.
[19] Nolan (n 14 above) 93; for criticism, see G Virgo *The Principles of the Law of Restitution* (OUP Oxford 1999) 526.
[20] *Lewin on Trusts*, 17th edn, Mowbray et al (eds) (Sweet & Maxwell London 2000) § 20–01.

analysis is that where a trustee of a lease renews it in his own name he is deemed in equity to be a constructive trustee for those interested in the original term:[21] the new lease is deemed to be a graft upon the old one.[22] The rule is an absolute one, save where the instrument constituting the trust contains an express contrary intention,[23] or where the lease is taken by the trustee with the concurrence of all beneficiaries after full and proper disclosure.[24] And, in the absence of such "authorization," the absolute nature of the rule means that the trustee cannot adduce evidence[25] to show that the landlord in fact refused to renew in favour of the beneficiaries,[26] and insisted on renewing in favour of the trustee in his personal capacity; nor that the co-trustees refused to concur in a renewal for the beneficiaries' benefit.[27]

From its origins in the cases concerning the renewal of a lease, the rule has been readily extended to apply to purchases of a reversion by a trustee in similar circumstances;[28] and from there to a wide variety of transactions between a trustee and a third party yielding a profit to the trustee. Thus, if a trustee enters into unauthorized trading with the trust property, for example by employing it for the purposes of his own business,[29] then he will be personally liable to pay compensation for breach of trust; and, if a profit results, the trustee will hold the profit on a constructive trust and be accountable accordingly.[30] Similar consequences now follow if a bribe or secret commission is paid to a trustee with a view to influencing him in the performance of his powers,[31] or if a trustee obtains remunerative employment with a third party by virtue of his position as a trustee, or use of the trust property,[32] or if he starts up a business in competition with a

[21] *Keech v Sandford* (1726) Sel Cas *t* King 61; *Pickering v Vowles* (1783) 1 Bro CC 197, 198, (Lord Thurlow); *Griffin v Griffin* (1804) 1 Sch & Lef 352, 354 (Lord Redesdale); *Nesbitt v Tredennick* (1808) 1 B & B 29, 46 (Lord Manners); *Turner v Hill* (1840) 11 Sim 1, 13 (Shadwell V-C); *Bevan v Webb* [1905] 1 Ch 620, 625 (Warrington J); *Re Knowles' Will Trusts* [1948] 1 All ER 866 (CA).

[22] *Bevan v Webb* [1905] 1 Ch 620, 625; *Griffith v Owen* [1907] 1 Ch 195, 204.

[23] *Re Knowles' Will Trusts* [1948] 1 All E R 866 (CA).

[24] *Re Jarvis* [1958] 2 All ER 336.

[25] For this way of putting this point, see text to n 40.

[26] As in *Keech v Sandford* (n 21 above).

[27] *Blewett v Millett* (1774) 7 Bro PC 367.

[28] *Protheroe v Protheroe* [1968] 1 WLR 519 (CA); *Thompson's Trustee in Bankruptcy v Heaton* [1974] 1 WLR 605; *Popat v Shonchhatra* [1997] 1 WLR 1367 (CA); *Don King Productions Inc v Warren* [2000] Ch 291 (CA) 340B (Morritt LJ).

[29] *Docker v Soames* (1834) 2 Myl & K 65 (Lord Brougham); *Jones v Foxall* (1852) 15 Beav 388; *Townend v Townend* (1859) 1 Giff 201; *Flockton v Bunning* (1873) 8 Ch App 323n.

[30] *Reid-Newfoundland Company v Anglo-American Telegraph Company Ltd* [1912] AC 555 (PC); *Brown v I R C* [1965] AC 244 (HL). As to election between the two remedies, see *Tang Man Sit v Capacious Investments Ltd* [1996] 1 AC 514 (PC).

[31] *Re Smith* [1896] Ch 71; *Parker v McKenna* (1874) 10 Ch App 96. No distinction is now drawn between bribes and secret commissions on the one hand, and open and honest commissions on the other. In each case a constructive trust will now be imposed in addition to the personal liability to account: *Att-Gen for Hong Kong v Reid* [1994] 1 AC 324 (PC). That said, this treatment of bribes is a matter of considerable controversy: see, in particular, Roy Goode "Proprietary Restitutionary Claims" in Cornish et al (n 14 above) 63. Goode's view is that a proprietary remedy ought not to be available in respect of a bribe.

[32] *Re Francis* (1905) 74 LJ Ch 198; *Re Macadam* [1946] Ch 284; *Re Gee* [1948] Ch 284.

business carried on by the trust.[33] Since each of these has been said to involve a breach of the conflict rule—that is to involve a trustee placing himself in a position where a personal interest conflicts with his duty—the trustee is liable to both a personal and a proprietary remedy, and there is no need to establish that the trustee has actually abused his position.[34]

Even in the limited context considered so far, of transactions with third parties yielding a profit to the trustee (renewals of leases, purchases of reversions, unauthorized trading, bribes and so on), the precise justification for the operation of the conflict rule has not proved easy to pin down. The early instances, concerning renewal of leases, may first have developed by reason of the value attaching to the customary (albeit unenforceable) right of renewal that tenants formerly enjoyed against charitable and public bodies,[35] and secondly by reason of the special position of minors with whom a landlord might be unwilling to renew in view of the minor's inability to give an enforceable covenant. But there is no doubt that the rule now extends beyond each of these situations.[36] The narrow rule affecting renewal of leases has more recently been said to be founded on public policy, based it seems on the fact that possession gives to a trustee an opportunity of renewal acting upon the goodwill that accompanies it,[37] a sitting tenant being better placed than a third party to obtain a new lease on favourable terms.

This apparent progression—from lease renewal, through other unauthorized transactions with third parties, to the receipt of bribes—is certainly the way in which the case law has developed. Although Finn treated the rule concerning leases as itself a distinct instance of the more general duty of good faith (*alongside* the conflict, profit and purchasing rules, rather than conscribed within any of them), it might be thought more helpful to say that the lease renewal cases have merged into the wider rule preventing conflicts of interest and duty generally. On this analysis, a trustee renewing a lease in his own favour places himself in a position where his duty to serve the interests of the beneficiaries (by renewing or considering renewal for the trust) conflicts with his personal interest in renewing in his own favour.[38] The rule proscribing such specific conduct can therefore be regarded simply as an instance of the more general prophylactic rule designed to foster loyalty within certain defined relationships, and paradigmatically to do so in the case of trustees.

[33] *Re Thomson* [1930] 1 Ch 203.
[34] *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324 (HL).
[35] S Cretney (1969) 33 Conv (NS) 161.
[36] *Griffith v Owen* [1907] 1 Ch 195, 204.
[37] *Re Biss* [1903] 2 Ch 40, 56–57 (Collins MR); see too *Griffith v Owen* (n 36 above) 204; *Re Knowles' Will Trusts* [1948] 1 All ER 866, 868 (CA).
[38] *Aberdeen Railway Company v Blaikie Bros* (1854) 1 Macq 461,472 (Lord Cranworth LC); *Swain v Law Society* [1982] 1 WLR 17, 29D (Stephenson LJ). See also *Regal Hastings v Gulliver* (1942) [1967] 2 AC 134n, 135–136 (HL); *Phipps v Boardman* [1967] 2 AC 46, 124F-G (HL).

That having been said, there is an apparent difficulty in regarding the lease cases as a particular instance of the more general conflict rule, in that it is not easy to see why there should be any possible conflict in a case where the lease *cannot* be renewed in favour of the trust—and yet it is quite clear that the specific proscription operates in such a case.[39] But Sir Peter Millett has suggested that this objection can be answered, because a trustee who holds a lease of property has an absolute duty to serve the interests of the beneficiaries by considering a renewal, and a court will never entertain an inquiry into the question whether the trustee was entitled to take no for an answer, so that the trustee can never establish that there was no possibility of conflict.[40] If this is the correct analysis, and if the lease cases where there is no real possibility of a conflict are to follow from an overarching conflict rule, then that overarching rule must be stated with some care. It must require not only that a trustee avoid actual conflicts, but also, where an advantage has apparently been taken which might have accrued to the trust, that a trustee is not to be permitted to adduce evidence to show that there was, in the particular circumstances, no actual conflict involved.[41] Such a wide formulation does not, however, involve reaching beyond the acknowledged prophylactic purposes of the conflict rule to some other, more abstruse, justification: it simply renders the successful fostering of loyalty more likely.

If this taxonomic step, incorporating the lease renewal cases into a carefully-expressed conflict rule, can be taken, then it might be thought possible to take a further step, and to regard the profit rule generally as merely part of the wider conflict rule.[42] The profit rule has certainly been described[43] as *part* of the wider rule that a trustee or other fiduciary must not place himself in a position where duty and interest may conflict. But it has also been maintained that there are in fact two distinct, though allied, rules; the profit rule being based upon the separate principle that an unauthorized profit, which is the fruit of the trust property, or of the trusteeship, is itself trust property.[44] Certainly the courts (as in the lease cases just considered) have been reluctant to accept that the profit rule

[39] Cases in n 21 above.

[40] Sir Peter Millett [1993] Restitution L Rev 7, 10. This way of putting the matter was again emphasized by Lord Millett in discussions at the colloquium at which these Chapters were discussed.

[41] Such an analysis may go further than that of Lord Upjohn in *Phipps v Boardman* [1967] 2 AC 46 (HL) 124, suggesting that, in order to count, the possibility of conflict must be real and sensible, and not fanciful. A trustee subject to the stricter version of the rule will be unable to demonstrate that the risk of conflict was merely fanciful.

[42] Text to n 20 above for a description of each rule.

[43] *Phipps v Boardman* [1967] 2 AC 46 (HL) 123 (Lord Upjohn); *Swain v Law Society* [1982] 1 WLR 17 (CA) 30–31 reversed by HL on other grounds [1983] 1 AC 598, but not so as to affect this principle; and is obliquely suggested (subject to debates about the precise import of semi-colons) by Lord Herschell's early formulation of the rules in *Bray v Ford* [1896] AC 44 (HL) 51: "It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondent's, is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict."

[44] *Swain v Law Society* [1982] 1 WLR 17, 36F (Oliver LJ); and see the Australian cases referred to in n 11 above, approved in *Don King Productions Inc v Warren* [1999] 3 WLR 276 (CA) 320–321.

should be *restricted* in its ambit by the need for a real conflict, such that the rule cannot apply in a case where there is no possible conflict between duty and interest. But this concern can be met in one of two ways. Either the genuinely distinct nature and extent of the profit rule must be accepted; or (again as in the lease cases just considered) the conflict rule must be stated so as to prevent the trustee from adducing evidence that there was in fact no possibility of conflict on the particular facts concerned.

However, the difficulties in the relationship between these two rules have still not been exhausted. Whether the conflict rule is a wider rule than the profit rule, or is a distinct though allied rule, the question remains whether there are circumstances in which a profit will be caught by the conflict rule despite not having been caught by the profit rule. It would seem from the cases that there are such circumstances, where a profit is made from taking advantage of a conflict (ie, from not preferring the interests of the beneficiary), but where the opportunity to make the profit cannot necessarily be said to have arisen from the trustee's fiduciary position. Unlike in the cases concerning the renewal of leases, the trustee might just as well have had the opportunity if he had not been in that position. In such circumstances, any liability that arises in respect of the profit can only do so because of the conflict, and not because of any misuse of the trustee's position or of the trust property. The clearest example may be where a trustee starts up a business in competition with a business owned by the trust, but is not enabled to do so either by reason of the trust property or the trusteeship. On the law as it currently stands, it is clear that the trustee in such a case is accountable for the profits of his competing business, and this must be because of an application of the conflict rule, and not the profit rule.[45] But that possibility having been recognised, if the conflict rule, properly expressed, is to be understood as the true basis both of the narrower profit rule, and of the even narrower rule concerning the renewal of leases, then it is scarcely surprising that such a conflict rule can also operate in circumstances not covered by either of the more precise rules. The argument that it is the conflict rule which lies at the centre of this area of law would be a curious argument if it could not.

## 2 No Third Party Involved: Self-Dealing and Fair-Dealing

Having considered the conflict rule as it applies to trustees in their dealings with third parties, the focus now shifts to such dealings as trustees may have with their beneficiary. The rules governing such circumstances appear to be of two distinct kinds. The first governs the attempted purchase of trust property by a trustee; and the second, the purchase by a trustee of a beneficiary's beneficial interest.

[45] *Industrial Development Consultants Ltd v Cooley* [1972] 1 WLR 443; *Scottish Co-operative Wholesale Society Ltd v Meyer* [1959] AC 324 (HL).

If a trustee attempts to purchase trust property for himself, he faces an initial hurdle—which has nothing to do with the conflict rule—that it takes two to make a contract. A purported purchase by a person from himself is ineffective because there is no contract;[46] and so the two party rule, as it is sometimes known, prevents a trustee from purchasing property which he holds as trustee—at any rate if there is precise identity of parties. Although, in the case of land, any attempted conveyance is effective to (re)vest the legal title in the trustee, since there is no valid contract of purchase by the trustee there is no basis upon which the equitable interest of the beneficiaries is capable of being overreached. The two party rule, however, is easily circumvented because it has no application to a sale to a nominee of the trustee; but a sale to a nominee of the trustee is void because it offends the genuine transaction rule:

> The sale is bad because it purports to be that which it is not, viz. an arm's length sale of the trust property to an independent third party. A trustee's power of sale does not authorise the trustee to sell the trust property except to someone with whom he can deal at arm's length. A sale to his nominee, being unauthorized, is incapable of overreaching the interests of the beneficiaries.[47]

The two party rule and the genuine transaction rule cannot, in any sense, be said to flow from the conflict rule, but they are strengthened by a wider principle which has been said to do so. By this rule, often called the "self-dealing" rule, a trustee is disabled from purchasing the trust property for himself.[48] It seems that the rule was developed because a person who undertakes to act for another in any matter cannot, in the same matter, act for himself.[49] The situation of a trustee gives him an opportunity of knowing the value of the property, and, as he acquires that knowledge at the expense of the beneficiary, he is bound to apply it for the beneficiary's benefit.[50] Rather than being based upon the consideration that a trustee cannot be both seller and buyer (the rationale of the two party rule and the genuine transaction rule), the "self-dealing" rule can readily be understood as based upon the wider principles of the conflict rule; a trustee who seeks to purchase trust property places himself in perhaps the

[46] *Rye v Rye* [1962] AC 496,513 (HL); *Kildrummy (Jersey) Ltd v IRC* [1990] STC 657, 662, 670. The position is different in the United States, where identity of parties may not prevent a contract if the capacities are different, see *Restatement (2d) Contracts* § 9.

[47] *Ingram v IRC* [1997] 4 All ER 395 (CA) 425d (Millett LJ) in a dissenting judgment which was approved on appeal, see [2000] 1 AC 293 (HL) 305D-H, 310G.The effect of both rules can be avoided by terms of the trust: *Lewin on Trusts* (n 20 above) §§ 20–58 and 20–59.

[48] *Fox v Mackreth* (1789–91) 2 Cox Eq Cas.320 (HL). The rule in fact extends further, so that it is also not possible for a trustee to take a lease of trust property for himself: *Re John's Assignment Trusts* [1970] 1 WLR 955, 960G-H, nor a loan from it: *Re Waterman's Will Trusts* [1952] 2 All ER 1054 and *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072(PC). As to whether the rule renders the trustee subject to a disability, or renders him vulnerable to a claim for breach of trust, *Tito v Waddell (No. 2)* [1977] Ch 106, 246–250; and Nolan (n 14 above).

[49] *Whichcote v Lawrence* (1798) 3 Ves Jun 740, 750 (Lord Rosslyn); *Ex p Lacey* (1802) 6 Ves Jun 625, 626 (Lord Eldon); *Re Bolye's Trust* (1849) 1 Mac & G 488.

[50] *Ex p Lacey* (1802) 6 Ves Jun 625; *Ex p James* (1803) 8 Ves Jun 337; *ex p Bennett* (1805) 10 Ves Jun 381; *Luddy's Trustee v Peard* (1886) 33 ChD 500.

clearest of all situations involving a conflict of duty and interest. Its application again does not depend upon any finding as to whether the trustee did in fact take any advantage of his situation, and so applies however honest the circumstances,[51] even though the price is fair,[52] and irrespective of whether any profit is made by the trustee.[53] It is, however, clear—as in the case of the conflict rule generally[54]—that the operation of the self-dealing rule can be excluded by an express term of the trust.[55]

The "self-dealing" rule does not, however, apply in relation to a purchase of a beneficial interest in the trust property by a trustee. Such a purchase is instead subject to a distinct rule, often called the "fair-dealing" rule,[56] that while the purchase is not voidable *ex debito justitiae*, it can be set aside by the beneficiary unless the trustee can show that he has taken no advantage of his position, that he has made full disclosure to the beneficiary, and that the transaction is fair and honest.

It has already been mentioned[57] that Finn, in his original work, doubted whether there was any value in dividing the purchasing rule, as he called it, into distinct "self-" and "fair-dealing" rules. Megarry J, deciding *Tito v Waddell (No. 2)* at around the same time Finn was writing, took a different view:

> Mr. Mowbray strenuously contended that there was only one rule, though with two limbs . . . . I can well see that both rules, or both limbs, have a common origin in that equity is astute to prevent a trustee from abusing his position or profiting from his trust: the shepherd must not become a wolf. But subject to that, it seems to me that for all practical purposes there are two rules: the consequences are different, and the property and the transactions which invoke the rules are different. . . . I shall accordingly treat the rules as being in essence two distinct though allied rules.[58]

Two recent cases, which will now be considered in some detail, have focussed attention on this issue once more. At the very least, they suggest that the "self-dealing" rule need not always apply in its full severity, and so appear again to blur the line between the transactions which invoke the two rules. Notwith-

[51] *Ex p James* (1803) 8 Ves Jun 337, 344.
[52] *Ex p James* (1803) 8 Ves Jun. 337, 47; *Aberdeen Railway Company v Blaikie Bros* (1854) 1 Macq 461, 471–472 (HL).
[53] *Campbell v Walker* (1800) 5 Ves Jun 678; *Ex p Reynolds* (1800) 5 Ves Jun 707; *Re Norrington* (1879) 13 ChD 654; there is a *dictum* to the contrary in *Whichcote v Lawrence* (1798) 3 Ves Jun 740.
[54] Text to n 23 above.
[55] *Bray v Ford* [1896] AC 44, 51 (HL); text to n 86 below.
[56] *Tito v Waddell (No. 2)* [1977] Ch 106, 240–241; *Re Thompson's Settlement* [1986] Ch 99. The important distinction seems to be that, although both self and fair dealing rules are applicable in the context of transactions between the parties to a fiduciary relationship, and where the transaction is within the scope of the fiduciary relationship, the fair dealing rule (as opposed to the self dealing rule) applies where the transaction is not brought about by the fiduciary in any sense *on behalf of* his principal: see Underhill & Hayton *The Law of Trusts and Trustees*, (15th edn Butterworths London 1995) 651–656, and the Law Commission, *Fiduciary Duties and Regulatory Rules* (Law Com. Consultation Paper No 124) para 3.4.33. When a beneficiary disposes of his beneficial interest, he does so *for himself*.
[57] See n 5 above.
[58] *Tito v Waddell (No. 2)* [1977] Ch 106, 241.

standing that the "self-dealing" rule has been said to be founded on the apparently unbending conflict rule, and despite some earlier *dicta* suggesting the contrary,[59] it seems that the presence of a conflict of interest in the case of certain transactions concerning trust property may sometimes operate merely to impose a burden on the trustee to prove that the transaction in question was fair and reasonable, and that he took no advantage of his position as trustee.[60] And, in the context of the exercise by trustees of their dispositive fiduciary powers, it seems that the rule may not even go so far as that.[61]

The first case to be considered took place in circumstances where the trustee had a personal interest in the sale of trust property despite being wholly unconnected with the purchase. *Public Trustee v Cooper* concerned private trustees who owned a significant holding of shares in a private company on trusts primarily for the benefit of the company's employees. The trustees received a take-over offer, on favourable terms, by a company wholly unconnected with any of the relevant trustees, in circumstances where the employees were largely opposed to the proposed take-over as being prejudicial to their interests. Given that none of the trustees was a direct purchaser, the case was not one calling straightforwardly for an application of the "self-dealing" rule; and, equally, the case did not obviously call for the application of the "fair-dealing" rule, since there was no disposition of any beneficial interest. However, one of the trustees also held a substantial minority holding in the company beneficially, and a further holding as one of the trustees of a charitable trust with a clear interest in the offer being accepted.[62] The trustees of the employee trust sought directions from the court whether they could accept the offer, without surrendering their discretion to the court, even though one of them was interested in other shares of the company. Hart J, after referring to the principle proscribing conflicts of duty and interest and the specific rules which have been founded on it, analysed the position as follows:[63]

> One must, however, beware of supposing, simply because the principle has bred these particular rules, that on every occasion on which the principle can be invoked in areas outside these specific rules some similar rigid rule either exists or should be crafted. There is in fact a surprising lack of English authority on the consequences of trustees acting or purporting to act in situations to which the developed rules do not in terms apply, but where actual or potential conflicts are alleged to exist. The relative absence of authority certainly suggests that there is no iron rule that, where such action has taken

[59] *Re Thompson's Settlement* [1986] Ch 99, 115F–H, critically considered in *Hillsdown Holdings plc v Pensions Ombudsman* [1997] 1 All ER 862, 895–896.
[60] *Public Trustee v Cooper* (Ch D, 20 December 1999) considered immediately below.
[61] *Edge v Pensions Ombudsman* [2000] Ch 602 (CA) considered in text from n 67 below.
[62] No distinction has been made in this Chapter between the situation where an alleged conflict exists between a trustee's duty and his personal interest, and that where the alleged conflict lies between two distinct fiduciary duties. There is no doubt, however, that the conflict rule applies to both circumstances. See the separate treatment of the two situations in Finn (n 1 above) chapters 21 and 22, also the formulation of the conflict rule in text to note 20 above.
[63] Transcript 51.

place, a beneficiary is entitled ex debito justitiae to have it set aside. Equally, one would expect to find, in the absence of such an iron rule, that, where such action is challenged on such grounds, the onus would be thrown on the trustee to demonstrate that the conflicting interest or duty has not in fact operated in a vitiating way.

This analysis suggests that, where the "self-dealing" rule is not directly applicable, because there has been no direct purchase by a trustee of trust property, but where there is still a potential conflict, then such a risk can be managed by means of a principle operating in much the same way as the "fair-dealing" rule. Hart J approached the position of trustees in such circumstances having considered a range of possible analogies:[64]

In some areas of our law the existence of conflicts of this kind is recognised and managed by a variety of devices, ranging from requiring the affected person to declare his interest to requiring him to abstain from participation in the relevant decision-making process. In the law of private (ie, non-charitable) trusts, where unanimity of decision making is required, such devices are difficult to transplant. The beneficiary is entitled to the decision of all his trustees but, at the same time, he is entitled to require that the decision is made independently of any private interest or competing duty of any of the trustees. Where a trustee has such a private interest or competing duty, there are, as it seems to me, three possible ways in which the conflict can, in theory, successfully be managed. One is for the trustee concerned to resign. This will not always provide a practical or sensible solution. The trustee concerned may represent an important source of information or advice to his co-trustees or have a significant relationship to some or all of the beneficiaries such that his or her departure as a trustee will be potentially harmful to the interests of the trust estate or its beneficiaries.

Secondly, the nature of the conflict may be so pervasive throughout the trustee body that they, as a body, have no alternative but to surrender their discretion to the court.

Thirdly, the trustees may honestly and reasonably believe that, notwithstanding a conflict affecting one or more of their number, they are nevertheless able fairly and reasonably to take the decision. In this third case, it will usually be prudent, if time allows, for the trustees to allow their proposed exercise of discretion to be scrutinised in advance by the court, in proceedings in which any opposing beneficial interests are properly represented, and for them not to proceed unless and until the court has authorised them to do so. If they do not do so, they run the risk of having to justify the exercise of their discretion in subsequent hostile litigation and then satisfy the court that their decision was not only one which any reasonable body of trustees might have taken but was also one that had not in fact been influenced by the conflict.

The analysis here clearly takes place within the model of an over-arching conflict rule, with its origins, as described above, firmly in those principles governing the situation of express private trustees. Curiously, however, it is the very fact that one is dealing with express private trustees which causes the difficulty in cases such as this. Although the situation of such a trustee is the paradigmatic instance of someone subject to the fiduciary obligations of the conflict rules,

[64] *Public Trustee v Cooper* (n 60 above) 52–53.

such a trustee is equally subject to the obligations imposed by the particular requirements of his express trust. It may be that one trustee faced with such a conflict, and who is merely peripheral to the management of the trust, can sensibly resign (a first category case). Where, however, the conflict affects a majority of the trustees, then an application to the court would appear essential (a second category case). In the third category of case, it may be *necessary* to proceed without resignation, because the trustee's specific expertise is required; and, it seems, *possible* to proceed without an application to the court, because the trustees as a body are able fairly and reasonably to take the necessary decisions. The facts in front of the court were apparently such a case. Hart J held that the "self-dealing" rule (or, perhaps more accurately, the conflict rule on which it is based) did not apply in its full rigour in relation to the employee trust. Instead the burden was on the trustees to demonstrate that the conflicting interest or duty had not in fact operated in a vitiating way; and, on the facts, that burden was discharged so that there was no need for the trustees to surrender their discretion to the court. In its effects, of course, this amounts to an application of the "fair-dealing" rule, but the consequences are imposed, not *as an application* of the "fair-dealing" rule, but instead as the most appropriate manner in which to manage a conflict between duty and interest in the face of competing considerations flowing from the special circumstances of the particular express trustee concerned.

## 3 Trustees Interested in the Exercise of Dispositive Powers

In *Cooper*, the alleged conflict arose when trustees were called upon to determine whether or not to exercise their *administrative* powers of sale of the trust property; and the particular personal advantage taken (on the sale of other shares in the relevant company) could not, in any case, have accrued to the beneficiaries concerned. But a similar difficulty in the application of the conflict rule to the position of express trustees has now become apparent in circumstances which might be thought to represent an even more central instance of fiduciary rigour, that is, where trustees exercise their *dispositive* powers over the beneficial interests.

It might be thought that the "self-" or "fair-dealing" rules, or something like them founded upon the conflict rule, would even more obviously apply to disable trustees from exercising fiduciary dispositive powers in favour of themselves. Such a rule is not needed in the context of personal powers, since the donees of such powers have no fiduciary duties in relation to their exercise, and so the question of conflict of duty and interest does not arise.[65] But when one moves

[65] Personal powers are subject to the doctrine of fraud on the power and may be regarded as fiduciary in the sense that there is a duty to the beneficiaries interested in default of their exercise not to exercise such powers otherwise than for an authorized object of the power: *Mettoy Pension Tustees Ltd v Evans* [1990] 1 WLR 1587, 1613G–1614A. But if the donee of a personal power is, as

into the context of fiduciary powers, where such a rule might be thought almost self-evidently necessary, there again emerges a serious difficulty in applying general fiduciary principles to this seemingly paradigmatic situation. Although fiduciary relationships in general can be said to involve a strict prophylactic duty of loyalty, requiring one person to act exclusively for the benefit of another or others,[66] the problem in applying such a formulation to trustees is that there is no necessary severance between the trusteeship and the beneficial interests. Just as the fact that the beneficiaries were entitled to the unanimous decision of their trustees caused difficulty in applying the straightforward dictates of the conflict rule to the facts of the *Cooper* case, so trustees can be, and frequently are, beneficiaries; and—whatever the dictates of the conflict rule may be—are entitled, as such, to benefit from the enjoyment of the trust property.

Indeed, there is nothing at all unusual in this sort of "conflict" affecting express private trustees. Even in the context of merely administrative powers, and where they are not personally interested, trustees will be faced with decisions which affect the beneficiaries in different ways, for example investment decisions which affect the yield of a trust fund, or the prospects of long term capital growth. The problem is more acute when one turns from the administrative powers of trustees to their dispositive powers. In circumstances where the trustees are not themselves interested in the exercise of the power, it is clear that they are entitled to be partial, in that they must, in exercising the power at all, necessarily prefer some beneficiaries over others. But their entitlement to be partial is subject to a duty to consider the exercise of such powers from time to time, and to exercise them in good faith, taking into account relevant considerations but not taking into account irrelevant, irrational or improper factors. A recent decision of the Court of Appeal has now addressed the even more difficult question of the position of a trustee who might *personally* benefit from the exercise of a dispositive power in a particular way.

*Edge v Pensions Ombudsman*[67] concerned a pension scheme providing retirement and other benefits for employees of industrial training boards, and funded by contributions from employers and employees while in service. The trustees of the fund comprised nine employers, nine employees and two pensioners. In order to reduce a substantial surplus in the fund, which would otherwise attract

a matter of construction of the power, an object of it, there is nothing in the doctrine of fraud on the power which precludes an exercise of the power in favour of the donee: *Taylor v Allhusen* [1905] 1 Ch 529; *Re Penrose* [1933] Ch 793.

[66] *Bristol and West Building Society v Mothew* [1998] Ch 1, 18–19 (CA), approved *Arklow Investments Ltd v Maclean* [2000] 1 WLR 594 (PC).

[67] [2000] Ch 602 (CA). The problem raised by this case has been resolved for the future, in some instances at least, by s 39, Pensions Act 1995, which came into force on 1 January 1996, in regard to pension schemes regulated by that Act, and provides: "No rule of law that a trustee may not exercise the powers vested in him so as to give rise to a conflict between his personal interest and his duties to the beneficiaries shall apply to a trustee of a trust scheme, who is also a member of the scheme, exercising the powers vested in him in any manner, merely because their exercise in that manner benefits, or may benefit, him as a member of the scheme."

adverse taxation, the trustees amended the rules pursuant to powers under the scheme and, after considering actuarial reports and the various options for reducing the surplus, reduced the contributions made by employers and employee members in service and increased pension benefits to members in service, but did not confer any benefits on pensioners. A number of pensioners complained to the Pensions Ombudsman under section 146(1) of the Pension Schemes Act 1993, arguing that, by virtue of the amendments, they had "sustained injustice in consequence of maladministration."

Following an investigation, in which the trustees had a full opportunity to put their case, but neither the employers nor employee members were represented, the ombudsman determined that the trustees had acted in breach of trust in that they had failed to act impartially as between the different classes of beneficiaries, and that the trustees who were employees and would benefit from the amendments had breached their duty not to put themselves in a position of conflict of interest and would have to account for any benefits received. The ombudsman directed that the amendments be set aside and the scheme administered as if the amendments had never been made. An appeal by the trustees to the High Court was allowed, and that decision has now been confirmed by the Court of Appeal.

The ombudsman had identified two relevant questions. First, whether the trustees had breached their duty to act impartially as between the different classes of beneficiaries; and, secondly, whether they had breached their duty not to put themselves in a position of conflict of interest.[68] He expressed his conclusion on the first issue as follows:[69]

> None of the trustees acted in personal conscious bad faith . . . However, the decision of the trustees . . . was a breach of trust, and an act of maladministration. The trustees breached their duty of impartiality, they did not act in the best interests of all the beneficiaries, and they exercised their power for an improper purpose. The injustice to the complainants is manifest.

It is, of course, the second question with which this Chapter is primarily concerned; and here the ombudsman held that any benefits to be received by the trustees, as members, under the amended rules must be repaid. The trustees:[70]

> were prohibited from allowing any conflict of interest and duty and from receiving or retaining any profit, such as an increase in benefits from their trust . . . The application of this prohibition in cases such as the present would not mean that the exercise of the power to increase benefits was void or voidable, but merely that the trustees concerned would not themselves become entitled to the increased benefits and would have to account to the trust for any received.

Sir Richard Scott V-C, whose approach the Court of Appeal endorsed in a judgment of the Court given by Chadwick LJ, could not accept that the trustees

[68] Para 29 of the ombudsman's determination (quoted by Chadwick LJ 614B).
[69] Para 54 of the ombudsman's determination (quoted by Chadwick LJ 614C–D).
[70] Para 55 of the ombudsman's determination (quoted by Chadwick LJ 614G–H).

could be criticized on the first basis. The trustees were entitled to be partial: they were entitled to exclude some beneficiaries from particular benefits and to prefer others:

> If what is meant by "undue partiality" is that the trustees have taken into account irrelevant or improper or irrational factors, their exercise of discretion may well be flawed. But it is not flawed simply because someone else, whether or not a judge, regards their partiality as "undue". It is the trustees' discretion that is to be exercised. Except in a case in which the discretion has been surrendered to the court, it is not for a judge to exercise the discretion. The judge may disagree with the manner in which trustees have exercised their discretion but, unless they can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be said to be one that no reasonable body of trustees properly directing themselves could have reached, the judge cannot interfere. In particular he cannot interfere simply on the ground that the partiality showed to the preferred beneficiaries was in his opinion undue.[71]

There is clearly a public law element involved in the examination of the trustees' (and the ombudsman's) powers undertaken by the High Court and the Court of Appeal in their consideration of the first question. The ombudsman was found to have asked himself the wrong question in so far as he had considered directly whether the trustees' decision was "fair." The correct approach was to ask whether particular matters were irrelevant, so that the trustees could be said to have acted irrationally or improperly in taking them into account. Assuming that the trustees were entitled to take particular matters into account, then it was for the trustees, and not the ombudsman, to decide the weight which particular matters should be given. In particular, it was for the trustees to decide whether the fact that pensioners were already adequately provided for by past increases in benefits and by index-linking was a sufficient ground for excluding them from further benefits. The fact that the pensioners were already adequately provided for (which was not challenged) could not be dismissed as irrelevant. The trustees' decision to give weight to that fact could not be categorized as irrational or improper. Further, the trustees were bound to have regard to the fact that the employers' consent had to be obtained. But it was for them to decide how far the employers could be pressed in negotiation; it was not for the ombudsman to substitute his own judgement for that of the trustees on a matter of that kind. Sir Richard Scott V-C in considering the first question, did not therefore find anything wrongful in the trustees taking account of the employers' concerns as well as those of their beneficiaries. The employers played "a vital part" in the pension scheme. They had to pay contributions, and they had to employ employees who were willing to join the scheme and to pay contributions. The continued viability of the respective employers was therefore something that the trustees were entitled to want to promote.[72]

But the Vice-Chancellor also rejected the ombudsman's contention that the equitable rule that a trustee must not allow himself to be placed in a position where his duty and interest conflict had the effect that, whenever the discre-

[71] [1998] Ch 512 (Sir Richard Scott V-C) 534, considered [2000] Ch 602, 618F–H (Chadwick LJ).
[72] *Edge v Pensions Ombudsman* (n 71 above) 537 considered 620F–G.

tionary power of amendment was exercised so as to increase an existing benefit or add a new benefit, member trustees must be excluded from that benefit. Were it otherwise, he suggested, then whenever the trustees exercised another one of their other discretions, (to set the level of members' contributions), in such a way as to reduce the contributions payable, the member trustees "would have to continue paying contributions at the higher rate."[73]

The Court of Appeal agreed with the Vice-Chancellor that the ombudsman's conclusions were "a consequence of his attempt to put himself in the position of the trustees and himself to decide what was fair."[74] Chadwick LJ was as influenced by the logic of public law in his approach to the second (conflict) question as he was in his approach to the first (relevance) question[75]—even going so far as to cite in full the seminal passage of Lord Greene's MR's judgment in *Associated Provincial Picture Houses Ltd v Wednesbury Corporation*.[76] Having done so, Chadwick LJ commented:

> It is unnecessary to consider, in the present case, how far an analogy between the principles applicable in public law cases can or should be pressed in the different context of a private pension scheme. But it is not without significance that the trustees in the present case—and, we suspect, in many cases of this type—are chosen for very much the same reason as that identified by Lord Greene M.R. . . .: "It is clear that the local authority are entrusted by Parliament with the decision on a matter which the knowledge and experience of that authority can best be trusted to deal with."[77]

The Court was certainly not troubled by regarding principles developed in the context of private discretionary trusts as being properly applicable in the modern context of a pension fund;[78] and, so, as in *Cooper*, the analysis took place against the background of an overarching conflict rule. But the manner of its application was again significantly moderated by a pragmatic recognition of the position in which these particular express private trustees found themselves. One approach to the friction between the conflict rule and the reality of the trustees' position might, as in the *Cooper* case, have been to apply the consequences of the "fair-dealing" rule,[79] rather than the "self-dealing" rule, so as to put upon the trustees the burden of demonstrating that they had acted fairly. But in the particular circumstance of the *Edge* case, even this would have conflicted with the public law analysis already undertaken by the Court of

[73] *Edge v Pensions Ombudsman* (n 71 above) 539 considered 621F.
[74] [2000] Ch 602 (CA) 631 and [1998] Ch 512, 537H.
[75] Making the case also worthy of study in any consideration of Finn's fifth question as set out in the first paragraph of this Chapter.
[76] [1948] 1 KB 223 (CA) 228–231.
[77] [2000] Ch 602 (CA) 630B-C; similar point made by Hart J in the passage from the *Cooper* case set out at n 64 above.
[78] *Edge v Pensions Ombudsman* (n 77 above) 627F–H. Contrast Lord Browne-Wilkinson in *Target Holdings* Ltd *v Redferns* [1995] 3 WLR 352, 362: "in my judgment it is important, if the trust is not to be rendered commercially useless, to distinguish between the basic principles of trust law and those specialist rules developed in relation to traditional trusts which are applicable only to such trusts and the rationale of which has no application to trusts of quite a different kind."
[79] Considered in text to n 56 above.

Appeal, in that it would have required an examination of the *reasons* for the trustees' decision. Chadwick LJ continued:[80]

> The only sensible conclusion in a case like the present is to accept that the scheme was established on the basis that the elaborate provisions regulating the composition of the trustees as a body were intended to provide a body of trustees which could be relied upon to consider all interests fairly and properly; and that those who seek to challenge a decision of that body should bear the ordinary burden of establishing that the decision has been reached improperly. That is not, of course, to say that the court, or the ombudsman, cannot draw appropriate inferences from any failure of the trustees to give an explanation when an explanation is called for; nor that the court, or the ombudsman, should not examine critically any explanation that is given. It is, however, to reject the submission that, in the present case, it was for the trustees to justify to the ombudsman the decision which they took.

The *Edge* case is therefore an instance of trustees, manifestly in a position of conflict between their duty and their personal interest, being subjected neither to the requirements of the "self-dealing", nor even of the "fair-dealing", rule. This, at first sight surprising,[81] conclusion has been arrived at, to put the matter in general terms, because of a pragmatic recognition of the *various* needs which beneficiaries have of their trustees. That they should avoid conflicts of interest may be one such need; but, in addition, the *Cooper* case recognises that a particular trustee may "represent an important source of information or advice to his co-trustees or have a significant relationship to some or all of the beneficiaries such that his or her departure as a trustee will be potentially harmful to the interests of the trust estate or its beneficiaries";[82] and, in *Edge*, that "the elaborate provisions regulating the composition of the trustees as a body were intended to provide a body of trustees which could be relied upon to consider all interests fairly and properly."[83]

At a more technical level, these decisions can perhaps be explained as follows. It has already been seen that any general formulation of the conflict rule must be stated in careful terms. It must require not only that a trustee avoid conflicts of interest and duty, but also that a trustee, in circumstances of suspicion, not be permitted to adduce evidence to show that there was in fact no possibility of a conflict at all.[84] But even this is not a sufficiently careful description of the principle, for it seems that the precise rule extends only to prevent a trustee *from placing himself* in a position where his interest and duty conflict, and not to situations where the trustee was placed in that position by external circumstances.[85] There is, accordingly, no doubt that the "self-dealing" rule can be excluded by the trust

80 [2000] Ch 602 (CA) 633B.
81 Contrary *dicta* in n 54 above.
82 See the end of the first paragraph of the quotation at n 64 above.
83 See the beginning of the quotation at n 80 above.
84 Text at n 41 above, and that following n 44 above.
85 *Bray v Ford* [1896] AC 44 (HL) 51; *Space Investments Ltd v Canadian Imperial Bank of Commerce Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072 (PC)1075; *Sargeant v National Westminster Bank plc* (1990) 61 P & CR 518 (CA)521–522. See too *Bristol and West Building Society v Mothew* [1998] Ch 1 (CA)18–19.

instrument;[86] and the decisions in *Cooper* and in *Edge* may go no further than recognize that the rule can be *impliedly* as well as expressly excluded.

Certainly, in so far as the decision in *Edge* flows from the recognition that a settlor's exclusion of the "self-dealing" rule can be implied as well as expressed, then more straightforward instances can readily be envisaged. For example, where the terms of a trust appoint A and B as trustees and also confer a power on the trustees to appoint among a class consisting of A, X and Y. If the "self-dealing" rule were applied, or something like it stemming from the conflict rule, then the power would become a power for the original trustees to appoint to X and Y, but that is not what the settlor provided for. The recognition that something which can be done expressly can also be done by necessary implication from surrounding circumstances may not seem ground-breaking, but the potential significance of the development should equally not be overlooked. If it is correct that it is possible to authorize a trustee, who is also a beneficiary, to exercise a fully fiduciary power under which the trustee can benefit over other beneficiaries; and that such a situation does not throw on the trustee the burden of showing that the power has been exercised rationally and properly,[87] then is reconsideration required of the position of an original trustee who already carries out a competing business with the trust, or of the position of a trustee who takes a lease for himself following a refusal to renew in favour of his beneficiary? The former case, at least if it could be shown that the settlor was aware of the trustee's competing activities at the time of his appointment, might seem a clear case for the kind of reasoning recognised in *Cooper* and in *Edge*. But the second would require a rather more fundamental alteration to the conflict rule, so as to allow a trustee to demonstrate that, in the circumstances of a particular case, there was in fact no actual conflict present between duty and interest; and this may be thought to constitute too much of a threat to the prophylactic intent of the conflict rule as a whole. Whilst, therefore, the first development in the law may reasonably be expected to take place in an appropriate case, the prospect of the second must be rather more remote.

## C CONCLUSIONS

The examination undertaken in this Chapter of the development of the conflict, profit, "self-" and "fair-dealing" rules, as they apply to express private trustees, began in the hope that the legal position at this historical and analytical heart of fiduciary law might be particularly clear. That hope has perhaps not been fully realised, but it can at least be maintained that each of the instances of these various rules should be understood as a particular application of an overarching conflict rule. For this to be possible, the rule must be stated with some care, but probably with no more precision than is required when setting

[86] See n 55 above.
[87] The effect of the *Edge* case: [2000] Ch 602 (CA) 627–633.

out other unifying principles of judge-made law, such as the circumstances in which a common law duty of care arises. In its application to express private trustees, the overarching conflict principle, designed to foster loyalty by discouraging any preference for personal interest over duty, extends only to circumstances where a trustee *has placed himself* in the position of conflict; it does not apply where the trustee has been placed in that position, whether expressly or by necessary implication from the circumstances, by the settlor. That said, where advantage has been taken of an apparent, and self-induced, conflict, a trustee is not entitled to adduce evidence to show that, in the particular circumstances, there was in fact no possibility of a conflict at all.

Although the conflict principle underlies, and circumscribes, the profit, self- and fair-dealing rules, the possibility of conflict is not the only matter to be taken into account when particular actions of express trustees come before the court. An express trustees' beneficiaries are entitled to more than simply the avoidance of conflicts of interest, and, in particular, that each trustee respect the specific circumstances of his trust, whether these have been expressed by the settlor or must necessarily be implied from the surrounding circumstances.

One final matter should be dealt with briefly, which is the possibility of locating these conclusions within the breadth of academic debate described at the outset of this Chapter. In terms of the insights of Gareth Jones,[88] it certainly might be said that there has been no technical wrongdoing in the sorts of facts encountered by the courts in *Cooper* and in *Edge*, such that, had the decisions gone the other way, they might have been regarded as instances of restitution for wrongs. Further, Jones' suggested approach neatly explains why it is that the purely policy-driven, but strict, prophylactic rule is not applied in all circumstances. It is simply that the prophylactic rule, ultimately designed to foster loyalty, comes up against equally compelling arguments demanding the loyalty of the trustee to the terms of the trust. In particular circumstances, such as in the context of expert pension fund trustees, with specialist knowledge of the best interests of their beneficiaries as employees (including, it seems, their interests in the continuing existence of the employer(s) concerned) the final requirement of loyalty may simply be that the chosen trustees, where possible, reach *their* decision. The desirability of their doing so outweighs any absolute rule to avoid conflicts of interest.[89]

[88] Set out in text following n 12 above.

[89] So far as the suggestion that the self- and fair-dealing rules might be better understood as reversing unjust enrichment by subtraction is concerned (Nolan n 14 above), the analysis presented here suggests that there may be little to be gained in doing so. If the conflict principle underlies and circumscribes each of the various more particular rules, and is flexible enough to allow other aspects of the position of express trustees to be taken into account, then there seems little reason to appeal to a different method of analysis. The level of loyal commitment required by the conflict rule is unusual in our legal system, but in circumstances where it has been recognised—and the express trustee is the paradigmatic such instance—its detailed application is not readily reduced instead into the terms of a different legal concern. In particular, and as suggested in the text immediately preceding n 13 above, it seems unlikely that rules designed to *discourage* particular events from taking place, rather than honed as responses to them, will readily be comprehended in terms of the reversal of unjust enrichment.

# 4

# *Overreaching*

DAVID FOX

SUPPOSE THAT A trustee, T, has unlimited powers of sale and investment over the trust fund. He holds some shares on trust for the beneficiary, B, as life tenant. If, in the proper exercise of his powers of disposition, T sells the shares, the purchaser, P, takes T's legal title to them clear of B's original equitable interest. There is no need for P to prove that he took the shares as a bona fide purchaser without notice of B's interest to achieve this result. Moreover, B's equitable life interest automatically transposes itself to the money proceeds arising from the sale. The money, and whatever T may buy with it, becomes impressed with the same trusts as the original shares.

This simple example illustrates the effect of the doctrine of overreaching.[1] Overreaching is a necessary corollary of T's powers of disposition over the trust fund.[2] These powers may be conferred by the express terms of the trust deed or by the general law. In the context of trusts, overreaching is primarily a mechanism by which T is enabled to transfer individual assets out of the trust fund so as to confer on the transferee a title clear of any beneficial interests or powers which affected the assets when T held them. The secondary aspect of overreaching is that any substituted asset which T acquires in exchange for the original

[1] The most comprehensive study of overreaching is that of C Harpum "Overreaching, Trustees' Powers and the Reform of the 1925 Legislation" [1990] CLJ 277. This paper draws heavily on Mr Harpum's analysis, which was endorsed by the Court of Appeal in *State Bank of India v Sood* [1997] Ch 276 (CA). Overreaching is best known in the context of dispositions of land by a trustee. A trustee's ability to overreach the beneficial interests in land is subject to the restrictions defined in the Law of Property Act 1925, ss 2 (1)–(2), 27(2). In a typical case, these provisions allow overreaching only if the sale or mortgage proceeds are paid to two trustees of land or to a trustee corporation. However, these provisions of the Law of Property Act 1925 do not confer on the trustee of land the power to make an overreaching conveyance. They merely limit the powers to overreach that he would otherwise enjoy under the general law (see now the Trusts of Land and Appointment of Trustees Act 1996, s 6 (hereafter TLATA 1996) which confers on the trustee of land all the powers of an absolute owner). Overreaching applies to dispositions of personal property held on trust without the restrictions enacted in the Law of Property Act 1925 (see now Trustee Act 2000, ss 3, 6, 7(1), 8, 9 which define trustees' general powers of investment and acquisition of land). For a general review: Harpum [1990] CLJ 277, 277–278.

[2] For present purposes, the power to dispose of a trust asset free of the trusts affecting it includes a duty to dispose of it, which, necessarily, imports the power to fulfil the duty. For the relevance of this to T's duty to realise an unauthorized investment, see text accompanying nn 28–29 below.

trust asset becomes subject to the same equitable interests or powers as affected the original asset.[3] By operation of law, B's interest in the original asset is transposed to the substitute, without the need for any express re-settlement or attornment by T.

Suppose now a second transaction in which T has limited powers of sale and investment over the trust fund. T sells an original holding of shares held for B as life tenant without obtaining the consent of some third person, as the terms of the trust require him to.[4] This is an unauthorized sale, beyond T's power of disposition. It is also a breach of trust. T's ability to overreach B's interest is an incident of a properly exercised power of disposition. If therefore T acts without the authority conferred by that power, overreaching can have no place in the transaction. *Prima facie* B's equitable interest in the shares can subsist so as to bind P, though it would be extinguished if P acquired the legal title to them as a bona fide purchaser. As far as P is concerned, the second transaction is very different from the first.

From the point of view of B, however, the effect of the unauthorized transaction may look deceptively as if overreaching has taken place. As will be considered below,[5] the very fact of the unauthorized exchange of the original shares for the money, will confer on B an equitable title to the money because it represents the traceable proceeds of the original asset in which B had an equitable interest. As an incident of that title, B has an unfettered election to assert over the money either a lien for the value of the misapplied shares or a beneficial interest equivalent to that which he had in the original shares. If B opted for the beneficial interest, he would end up with an interest in the substitute which was equivalent to that which he had in the original asset.

The broad aim of this paper is to investigate the similarities and differences between these two mechanisms for creating rights in substituted trust assets. Both are ways by which B takes a property right in a substituted asset, so allowing the trust fund to perpetuate itself, despite the change in composition of the individual assets that comprise it from time to time. The paper first considers the relevance of the distinction between authorized and unauthorized dispositions of trust property. Secondly, it compares the characteristics of the title to a substitute asset which B obtains as a result of an overreaching disposition by T, with the title B gains to a substitute by virtue of tracing after an unauthorized disposition. Thirdly, the paper considers the differences in B's rights against P, the third party purchaser who acquired the original trust asset from T, either as

[3] This aspect of overreaching is described as secondary because overreaching can occur even if T acquires nothing in return for the disposition of the original asset: *State Bank of India v Sood* [1997] Ch 276 (CA). Hence if T were empowered to make gifts from a trust fund by exercising a power of appointment, the disposition could still overreach any interest or power affecting the trust property. P, the object of the power, would take the property clear of any equitable right to which it might previously have been subject.

[4] The example derives from the fact of *Power v Banks* [1901] 2 Ch 487.

[5] See text accompanying nn 15–16 below.

a result of an authorized, overreaching, disposition by T, or as a consequence of T's unauthorized disposition to P. These rights are markedly distinct, depending on whether the disposition to P effectively overreached B's beneficial interest in the original asset or not. They therefore present some of the most important differences between authorized and unauthorized dispositions of trust property.

Finally, the paper investigates whether any real differences exist between transactions in which B adopts an unauthorized investment and those where he merely elects to enforce his title to a substituted asset acquired in an unauthorized transaction.

## A THE RELEVANCE OF THE DISPOSITION BEING AUTHORIZED OR UNAUTHORIZED

A point which is commonly overlooked is that, in claims founded on tracing, B may only assert an interest in the proceeds of his original asset if T disposed of that original asset outside his powers of disposition. If, in the proper exercise of his powers, T disposes of an original trust asset, then B can assert no proprietary interest in that asset or any other asset which P may substitute for it, even if they are identifiable according to the conventional rules of tracing.

At a somewhat general level, this result can be explained as depending on the now familiar distinction between tracing and so-called "claiming."[6] There is an analytical difference between the purely evidential process of identifying the passage of value through a series of exchange transactions, and the enforcement of some proprietary interest in the asset into which that value is traced. More precisely, the reason for this outcome is overreaching. Overreaching is an incident of the powers of disposition conferred on T. If, therefore, T makes an authorized disposition of the original trust asset, B's equitable interest in it is necessarily extinguished. B can no longer assert any proprietary claim to that original asset, nor to any other asset which P may acquire in exchange for it. If, on the other hand, T makes an unauthorized disposition of the original trust asset, then overreaching has no part to play either in extinguishing B's interest in the original asset or in transposing it to the substitute acquired in exchange. Whatever interest B takes in the product of an unauthorized exchange must be explained by another doctrine.

The case where this precise distinction was in issue is *Space Investments Ltd v CIBC (Bahamas) Ltd*.[7] Ironically, it is perhaps better known for the chance

[6] *Foskett v McKeown* [2001] AC 102 (HL) 127–128 (Lord Millett) and LD Smith, *Law of Tracing* (OUP Oxford, 1997) 6–14.

[7] [1986] 1 WLR 1072 (PC). The distinction between authorized and unauthorized dispositions of trust assets was also a relevant issue in *Taylor v Plumer* (1815) 3 M & S 562, 105 ER 721. Counsel for the assignees in bankruptcy of T argued that B could only claim an equitable interest in a substituted asset acquired by T if T had acted within his authority when he disposed of B's original asset. Counsel apparently assumed that B's title to the substitute could only arise through overreaching; or as an incident of a fiduciary's duty to account for property acquired on the principal's

dictum of Lord Templeman on the "swollen assets" theory of tracing than it is for the point actually argued and decided. The beneficiaries of a trust asserted a proprietary claim over the remaining assets of an insolvent bank which had accepted deposits of their trust money. The complication was that the bank was also the beneficiaries' trustee. The trust deed authorized the bank, in its capacity as trustee, to deposit the trust funds with any bank, including itself. In due exercise of this power of investment, the bank, as trustee, deposited trust money with itself, as banker.

Delivering the advice of the Privy Council, Lord Templeman held that the beneficiaries' claim to any proprietary interest over the bank's remaining funds necessarily failed. Even apart from whether the beneficiaries could still trace the surviving proceeds of their deposits in the bank's assets, they could no longer have any proprietary interest in the trust funds deposited with the bank.

Explained as an instance of overreaching, the result of *Space Investments* is wholly supportable. The deposit of the trust funds at the bank was authorized by the terms of the trust deed. Therefore, any proprietary claim founded on tracing to recover that money or its proceeds was inapplicable. Such a claim had no place since the trustee had made an authorized disposition of their money. To put the point another way, since the trustee's deposit of trust money with itself as banker was an authorized disposition of the beneficiaries' original funds, their interest in the funds was overreached. The bank, as recipient, became the full legal and beneficial owner of the original funds. Of course, the corollary of overreaching was that the beneficiaries took an equivalent interest in the asset which the trustee acquired in exchange for their original funds. But this asset was the trustee's chose in action against itself, as banker, entitling it to withdraw the amount of the trust deposit. In effect, the beneficiaries acquired by overreaching an equitable interest in a purely personal right of action against the bank, something which could not confer on them the status of secured creditors over the bank's remaining assets.

Two refinements should be added here to what is meant by an authorized disposition. The first is to emphasise that the distinction between rights triggered by tracing and those triggered by overreaching does not necessarily correspond to the distinction between dispositions amounting to an equitable wrong and those which do not amount to an equitable wrong. While every transaction by a trustee which is an equitable wrong will also be unauthorized, the converse is not necessarily true. For instance, if a trustee breaches the fiduciary self-dealing or fair-dealing rules, he does not commit any equitable wrong. He merely acts

behalf (*eg, Burdett v Willett* (1708) 2 Vern 63, 23 ER 1017); or where a covenant obliged a trustee to lay out trust money to buy land (*eg, Deg v Deg* (1727) 2 P Wms 412, 24 ER 791; *Sowden v Sowden* (1758) 1 Cox 165, 29 ER 1111). Lord Ellenborough rejected the argument and held that the unauthorized exchange of B's original asset would also confer on B a right to the substitute. He relied on *Lane v Dighton* (1762) Amb 409, 27 ER 274, where a life tenant used money from a marriage settlement to make an unauthorized purchase of land. The land was nonetheless held to be subject to the trusts of the original settlement.

beyond his proper powers.[8] But there is no doubt that a beneficiary can trace into and claim a substitute acquired in exchange for an original asset disposed of in breach of one of these rules on unauthorized dealings.[9]

The second refinement is that in asking whether the disposition is authorized or not, the inquiry turns on whether T has authority *as between himself and P* to make a disposition clear of B's beneficial interest. Situations exist where the simple fact that T incidentally commits some breach of trust *as against B* when he makes the disposition to P will not necessarily invalidate T's authority to deal with P and prevent overreaching from happening. The disposition is a single transaction but its effect has to be considered from the separate perspectives of B and P. T may incur liability to B for the wrong which he commits against him in the events leading up to the disposition, but the trustee's power to transfer a clear legal title to P may remain unimpugned.[10] This point is most likely to arise when T makes a disposition of registered land. In that context, T's power to confer a clear title on P will generally depend on the effect of section 18 of the Land Registration Act 1925 in granting him unlimited statutory powers of disposition as against a purchaser. It will not depend upon the powers granted to T under the express or implied terms of the trust or the general law. The Act may confer authority on T to make a valid disposition as between himself and P, even though as between T and B there is a breach of trust.

The clearest illustration of this point is *City of London Building Society v Flegg*,[11] the leading House of Lords' decision on the effect of an overreaching conveyance entered into by two trustees for sale of land. Mr and Mrs Maxwell-Brown held the legal fee simple in a house as trustees for sale on behalf of themselves and Mrs Maxwell-Brown's parents, the Fleggs. They later granted a legal mortgage over the house to the Building Society, entirely without the Fleggs' knowledge or consent. This transaction was a breach of trust as regards the Fleggs. The Maxwell-Browns did not fulfil their statutory duty to consult the beneficiaries and give effect to their wishes so far as those were consistent with the interests of the trust.[12] The House of Lords held, however, that this breach

[8] *Tito v Waddell (No 2)* [1977] 1 Ch 106, 240–241 (Megarry V-C).

[9] See generally R Nolan "Conflicts of Interest, Unjust Enrichment and Wrongdoing" Ch 7 in WR Cornish et al (eds), *Restitution-Past, Present and Future* (Hart Oxford 1998) 90–91.

[10] This distinction between the effect of authority as between T and P, and T and B is of general application. So under the Companies Act 1985 s 35A, it is presumed in favour of a person dealing with the company in good faith that the board of directors is free of any limitation under the company's constitution. Nonetheless, the directors remain liable to the company for the consequences of their actions, which were unauthorized as against the company. The distinction also applies in trust law in the context of B's decision to adopt an unauthorized investment made by T (see Section D below). When B adopts the unauthorized investment, he retroactively authorizes T's disposition of the original purchase money to P, the person who sold the investment to T. In doing so, however, B does not necessarily waive his right to sue T for any losses resulting from T's breach of trust in making the unauthorized investment. In the one transaction, T can be authorized as against P, but in breach of trust as against B.

[11] [1988] AC 54 (HL).

[12] Law of Property Act 1925 s 26(3) (since repealed and replaced by the corresponding provisions in TLATA 1996 s 11).

did not impugn the trustees' general power conferred by statute to grant a valid mortgage charge to the Building Society.[13] Consequently, the Fleggs' original beneficial interest in the fee simple was overreached to the equity of redemption and the mortgage proceeds. They could no longer claim to have a right subsisting with reference to the land, capable of binding the Building Society as an overriding interest for the purposes of section 70(1)(g) of the Land Registration Act 1925.

The very general observation of Lord Templeman that the "legal charge was entered into the by trustees in breach of trust"[14] can easily be misunderstood. It is accurate so far as it means that the incidental breach of trust did not invalidate the Maxwell-Browns' statutory authority as regards the Building Society to overreach the Fleggs' beneficial interest when they granted the mortgage. It would be inaccurate if taken to mean that overreaching could happen even though the very disposition to the Building Society was outside the Maxwell-Browns' dispositive powers.

## B THE BENEFICIARY'S TITLE TO A SUBSTITUTED ASSET ACQUIRED IN AN UNAUTHORIZED TRANSACTION

If T makes an unauthorized sale of an original asset, B takes an equitable title to the substituted asset acquired in exchange. The question is whether the nature of B's title to this substitute is substantially different from what it would have been if the sale had been authorized, so that B's interest in the original

[13] The House of Lords considered that the Maxwell-Browns derived their general power to mortgage from the Law of Property Act 1925 s 28(1). The alternative view, for which Mr Harpum argues, is that as regards a purchaser or mortgagee they had unfettered statutory powers of disposition under the Land Registration Act 1924 s 18 by virtue of their status as registered proprietors of the freehold. Their powers of disposition as regards the Building Society could only have been limited if some restriction on their powers as trustees had been entered on the register in accordance with the Land Registration Act 1925 s 58. See [1990] CLJ 277, 305–310. In my opinion, this explanation based on s 18 holds good after the enactment of TLATA 1996. Two trustees of land who sell or mortgage a registered legal estate can still overreach the beneficial interests of B, even if in making the disposition they act in breach of their duties to B under TLATA 1996, ss 6(5), 7(3) or 11(1). The Land Registration Act 1925, s 18 conclusively defines the trustees' authority to confer title on P and hence to make an effective disposition to him, with the result that overreaching can happen. There is therefore no need for any statutory provision to protect P when T fails to discharge his duties to B. Overreaching happens because the disposition is authorized in the relevant sense. This is to be contrasted with statutory protections enacted for a purchaser of unregistered land in s 16 of TLATA 1996. They are necessary in unregistered land because T's authority to make an effective disposition to P depends entirely on the terms of the trust and his compliance with the general law. Consequently any incidental breach which T might have committed against B would directly impugn T's authority to make a valid disposition to P. Overreaching would become impossible and P would risk finding himself bound by B's equitable interest. See further M Dixon "Overreaching and TLATA 1996" [2000] Conv 267, rejecting the arguments of G Ferris and G Battersby "The Impact of TLATA 1996 on Purchasers of Registered Land" [1998] Conv 168.

[14] [1988] AC 54 (HL) 70.

asset was overreached and transposed to the substitute. Both are mechanisms by which B takes a property right in a substituted asset. If this same effect follows from the authorized or unauthorized sale of the trust asset, does it make any practical difference whether the exchange was authorized or unauthorized?

The starting point in considering the nature of B's title after an unauthorized exchange is the recent decision of the House of Lords in *Foskett v McKeown*.[15] In that case the beneficiaries of an express trust were allowed to trace into, and assert a proprietary claim to, the proceeds of a policy insuring the life of their trustee. Before his death, the trustee had wrongfully used trust funds to make two out of the five annual premium payments made under the policy, or at least for the purposes of the case was he was assumed to have done so. The majority of the House of Lords held that the defrauded beneficiaries had an unrestricted election to assert either a 40 per cent beneficial share in the insurance proceeds or a lien over them for the amount of the trust money which they could trace into the payment of the insurance premiums. Since the amount of the insurance proceeds far exceeded the amount of trust money misapplied to pay the premiums, the beneficiaries elected to take a proportionate share. The majority of the House of Lords upheld their right to do so.

*Foskett* is relevant for present purposes in the following way. The view of the majority was that the assertion of one of these proprietary claims was the remedy by which the beneficiaries vindicated a pre-existing title to the insurance moneys which represented the traceable proceeds of their original trust funds. The majority contemplated that the very fact of the unauthorized exchange conferred on the beneficiaries a title to the substitute. The majority apparently regarded the unauthorized exchange of a trust asset as a *sui generis* category of event leading to the creation of a fresh property right. The beneficiaries' title arose even before they asserted a lien or a beneficial interest since those were the remedies by which this title was enforced.[16]

The precise characteristics of B's title to the substitute acquired in an unauthorized disposition have been considered in two nineteenth century cases and in the academic literature.[17] *Cave v Cave*,[18] a decision of Fry J on the unauthorized investment of trust funds in land, holds that B takes a fully vested equitable interest in the substitute at the moment of exchange. B's interest has the same capacity to bind third parties as an equitable estate or mortgage charge. That said, the view which seems stronger in principle is that at the moment of

[15] [2001] AC 102 (HL).
[16] [2001] AC 102 (HL) 110G (Lord Browne-Wilkinson), 134C–D (Lord Millett). For attempts to posit a general rationale for the creation of property rights in substituted assets acquired by unauthorized exchange, see P Birks in this volume Ch 7, cf P Birks "Overview" in P Birks ed *Laundering and Tracing* (OUP Oxford 1995) 317–319, and D Fox "Vindicating Property in Substituted Assets", [2001] LMCLQ 1, 3–6.
[17] See Birks "Overview" (n 16 above) 307–311 and LD Smith *The Law of Tracing* (OUP Oxford 1997) 322–326.
[18] (1880) 15 ChD 639.

the unauthorized substitution, B's title to the substitute is inchoate in character. In *Re Ffrench's Estate* the Irish Court of Appeal explicitly adopted this view.[19] B's title is a mere equity.[20] It has incidents like those of an equity to rescind a transaction for fraud or to rectify a mistaken conveyance. B acquires a fully vested interest in the proceeds only when he elects to take the lien or the beneficial share. Until then, his title is not fully vested, though once vested it relates back to the time when T made the substitution.[21]

This represents the main difference between the title to the substituted asset acquired in an unauthorized transaction and an interest arising through overreaching in an authorized transaction. The latter is fully vested from the moment of the authorized exchange and ranks for the purposes of priority conflicts as an equitable estate, just as B's right in the original asset was. B does not have to exercise any election to claim an interest in the substitute. Overreaching ensures that B takes an interest in the substitute perfectly equivalent to that which he had in the original asset. B has no choice about the interest which he gets in the substitute. By contrast, the primary incident of B's inchoate title to the substitute acquired in an unauthorized exchange is that it permits him to elect to assert a fully vested equitable interest in the substitute—either a lien or a beneficial share. B's interest cannot crystallize fully until he has chosen one or the other.

Having said that, the analogy with an equity to rescind risks overstating the distinction between an inchoate title to a substitute acquired in an unauthorized exchange and a fully vested equitable estate acquired through overreaching. The distinction matters most critically in resolving priority conflicts between competing equitable claims to the same asset. Hence if an inchoate title were analogous to a mere equity to avoid a title for fraud, the general rule is that it would not bind a bona fide purchaser of a later equitable interest, whereas if it were a fully vested equitable interest, like an equitable estate, it could do.[22] The view

[19] (1887) 21 LR (Ir) 283 (CA Ir) esp Porter MR. For a full statement of the reasons in favour of B's interest being less than fully vested, Birks "Overview" 307–11 and LD Smith, *The Law of Tracing* (n 17 above) 322–326, 356–361.

[20] "Mere equity" is used here in the same sense as in RP Meagher, WMC Gummow and JRF Lehane, *Equity: Doctrines and Remedies* 3rd edn (Law Book Co Sydney 1992) paras 428–429 in contrast to a purely "personal equity" such as a right to contribution from a co-surety. The distinction is essentially between an equity having proprietary effect and capable of binding third parties, and one binding solely between the claimant and a specific individual.

[21] Cf *Bristol and West BS v Mothew* [1998] Ch 1(CA) 22–23 (Millett LJ) and *Twinsectra Ltd v Yardley* [1999] Lloyd's Rep Bank 438, 461 (Potter LJ) both considering the equity to rescind for fraud.

[22] *Phillips v Phillips* (1861) 4 De GF & J 218, 45 ER 1164 (Lord Westbury). A priority dispute among competing equitable claims to an asset made it necessary to analyse the characteristics of the beneficiaries' title in *Cave v Cave* (1880) 15 ChD 639 and *Re Ffrench's Estate* (1887) 21 LR (Ir) 283(CA Ir). In relation to land, the argument whether B's interest in the unauthorized substitute ranks for priority purposes as a mere equity or an equitable interest is growing less relevant as ever more land titles become registered. If the dispute were over registered land and none of the claimants had protected their interest by registering a notice under s 49 of the Land Registration Act 1925, B's title would only bind any later claimant if it ranked as an overriding interest under s 70(1)(g) of the Act. The traditional *Phillips* v *Phillips* priority rules would not apply. It seems that even an inchoate

argued for here is that this small difference in the extent of its enforcement against third parties with competing claims to the trust asset, does not undermine the essentially proprietary character of B's inchoate title.

Consistent with this proprietary character, B's inchoate title attaches to the specific traceable proceeds of the original asset. It does not merely give B personal rights against T. B can enforce it against donees deriving title from the person who made the exchange or a trustee in bankruptcy.[23] It is also enforceable against one taking the proceeds in bad faith or with notice of the breach.[24] B can assign it *inter vivos* or devise it by will.[25] A third party recipient of the traceable proceeds may be liable to B in a title-based personal action for restitution, even if he received the proceeds before B elected to vindicate his claim to them.[26] Being an equitable right, B's inchoate title is defeated if the substitute is

equitable title may have a sufficiently proprietary character to rank as an overriding interest if the claimant, B, is in actual occupation. Note, for instance, the analogy of the equity to rectify a conveyance for mistake considered in *Blacklocks v JB Developments (Godalming) Ltd* [1982] Ch 183 which has been held to be an overriding interest, and of an inchoate equity arising under a proprietary estoppel which may also rank as an overriding interest (see the cases gathered in Megarry and Wade, *Law of Real Property*, 6th edn by C Harpum, (Sweet and Maxwell London 2000) para 6–052, and argument of G Battersby "Informal Transactions in Land" (1995) 58 MLR 637, 640–643). If, on the other hand, the substituted asset were personal property, the dispute whether B's inchoate title would rank as an equitable interest or a mere equity could still be important. How the dispute would be resolved might depend on the kind of personal property being claimed. With shares or goods, the *Phillips v Phillips* priority rules would apply. A prior equitable interest would bind a later bona fide purchaser of an equitable interest, such as equitable assignee of the shares who had taken them as security for advances made to T. However, if B's inchoate interest in the shares or goods ranked as a mere equity, it would not bind the subsequent assignee for valuable consideration of the property. If the trust asset were a chose in action other than shares, such as a debt receivable by T, then the view which seems marginally stronger on the authorities is that the usual *Phillips v Phillips* priority rule would also apply. It seems that that would not be displaced by the rule in *Dearle v Hall* (1823) 3 Russ 1, 38 ER 475, which would have awarded priority to whichever claimant was first to give notice of his interest to T's debtor. That rule may only apply to priority conflicts between competing assignments of the same chose in action, not to a conflict between an interest under a trust and an interest under a later assignment: *Hill v Peters* [1918] 2 Ch 273; *BS Lyle Ltd v Rosher* [1959] 1 WLR 8 (HL) 22 (Lord Reid); *Compaq Computers Ltd v Abercorn Group Ltd*. [1991] BCC 484, 500–501(Mummery J) (where the point was left open); DW McLaughlan "Priorities—Equitable Tracing Rights and Assignments of Book Debts" (1980) 96 LQR 90, 95–100. It must be conceded, however, that none of these cases concerned an inchoate title to an unauthorized substitute, obtained in exchange for an original trust asset. They were concerned with a fully vested interest under an express trust. On the other hand, RM Goode, *Commercial Law* (2nd edn Penguin London 1995), 818–819 would make priority between all competing equitable claims to a debt depend on the rule in *Dearle v Hall*.

[23] Eg, *Foskett v McKeown* [2001] AC 102 (HL) where the beneficiaries' right to elect between a lien and a beneficial share was enforced against the defaulting trustee's children on whom he had settled the life insurance policy; cf *Load v Green* (1846) 15 M & W 216,153 ER 828: common law power to avoid a title for fraud enforced against the assignee in bankruptcy of the fraudulent party.

[24] Cf *El Ajou v DLH plc* [1993] 3 All ER 717, 739a (equity to rescind, Millett J indicating the availability of a proprietary claim).

[25] Cf *Stump v Gaby* (1852) 2 De GM & G 623, 42 ER 1015:equity to rescind for undue influence or breach of fiduciary fair dealing rule.

[26] Cf *El Ajou v DLH plc* [1993] 3 All ER 717 (Millett J); rvsd on other grounds [1994] All ER 685 (CA) equitable action for knowing receipt, where the claimant had an equity to rescind for fraud; *Lipkin Gorman v Karpnale Ltd* [1991] 2 AC 548(HL) action for money had and received, illustrating the corresponding position at common law.

transferred to a person taking the legal title as a bona fide purchaser for value. B could fully enforce his inchoate title to the substitute even against a person who had changed his position on the strength of receiving the substitute, at least where the substitute represented the proceeds of an original asset held on an express trust.[27] In these respects it would share all the characteristics of a fully vested interest in a substituted asset which T acquired in an authorized transaction where overreaching occurred.

B's inchoate title to the asset acquired in the unauthorized exchange can itself be overreached if T makes an authorized disposition of the asset. This would happen if T sought to make good his breach of trust by selling the unauthorized investment and re-investing the proceeds properly. The duty to sell, like a power to sell, would entail overreaching.[28] To this duty, there would be one exception. Provided that all the beneficiaries were *sui juris* and they agreed, they could elect to adopt the unauthorized investment so that T would no longer be under a duty to sell it.[29] That exception apart, the necessary concomitant of T's duty to sell would be that T could overreach B's inchoate title to the unauthorized investment. So, if P were to buy the unauthorized investment from T in these circumstances, he would take a clear legal title and B's inchoate title would be overreached to the sale proceeds. It would make no difference whether P had notice that the trust had a claim to the investment. As in other contexts, the very aim of overreaching would be to confer on P a clear title to the asset, regardless of whether he had notice that the asset had been subject to an interest under a trust. Provided that the unauthorized investment were actually sold for the purpose of restoring the trust fund, then B's proprietary claim could only ever be asserted against these proceeds of sale and any other asset acquired in exchange for them.[30]

Viewed in this way, overreaching explains the result of *Re Jenkins and HE Randall and Co's Contract*[31], the leading decision on the adoption of an unauthorized investment made by a trustee. The trustee misapplied trust money in buying a leasehold property. Later the executors of the original trustee sought to sell it. The purchasers questioned whether the executors could make a good

[27] D Fox "Vindicating Property in Substituted Assets" [2001] LMCLQ 1, 8.

[28] The obvious example would have been of the former trustee for sale of land exercising his duty to sell: Megarry and Wade, *Law of Real Property* 6th edn by C Harpum (Sweet and Maxwell London 2000) 376–378.

[29] *Re Patten* (1883) 52 LJ (Ch) 787; *Power v Banks* [1901] 2 Ch 487, esp 496 (Cozens-Hardy J); *Re Jenkins and HE Randall and Co's Contract* [1903] 2 Ch 362.

[30] This power to overreach when an unauthorized investment is sold goes some way towards solving the problem of a "geometric increase" in B's assets when T exchanges an unauthorized substitute for another asset (see Birks "Overview" (n 16 above) 308–309). Even if T sold the unauthorized investment to a purchaser with notice, B's title to that investment would be extinguished. This argument, however, would only apply where the sale of the unauthorized investment was made by a trustee seeking to reinstate the trust. There could be no overreaching, for instance, where a money launderer or trustee fraudulently made a series of substitutions with a view to making it difficult for B to trace the trust fund.

[31] [1903] 2 Ch 362.

title to the property without getting the consent of all the beneficiaries, some of whom were minors and therefore unable to agree to the sale. Swinfen Eady J held that in these circumstances the executors could convey a good title and that the purchasers should not have insisted on having the beneficiaries' consent. In my opinion, Swinfen Eady J was right. The purchasers' argument misunderstood the effect of overreaching. The fact that the beneficiaries could not all consent was actually an advantage to the purchasers. It meant that there was nothing to interfere with the executors' discharging their duty to sell the unauthorized investment in the leasehold property, and in doing so, overreaching the beneficiaries' interest from the property to the sale proceeds.

## C THE BENEFICIARY'S RIGHTS AGAINST THE TRANSFEREE OF THE ORIGINAL ASSET

The main differences between authorized and unauthorized dispositions appear when we compare B's rights against P, the purchaser to whom T transferred the original trust asset. As has been explained,[32] if T acts within his proper powers in disposing of the original asset to P, then B's original interest is overreached so that P takes a clear legal title to the asset. On the other hand, if the disposition to P is unauthorized, then the starting point must be that B's interest in the original asset survives the transfer. Granted, P may take the legal title to the original asset as a bona fide purchaser or the asset may be destroyed after P acquires it. These, however, are separate reasons for the extinction of B's interest in the original asset. In a case of overreaching, B has no claim to an asset sold by T because of facts relating to T: T's powers of disposition. In a case of bona fide purchase, B has no claim to the asset sold by T because of facts relating to P: P is, in his particular circumstances, immune to any claim in equity.

The consequence is that after an unauthorized sale of an original asset B may have to exercise an election.[33] Provided that the original asset remains identifiable and has not been received by a bona fide purchaser for value, B may vindicate his surviving title to that asset, or he may elect to trace and enforce his inchoate title to the substituted asset. If he elects for the latter, then he is essentially resorting to a secondary remedy. It is secondary in the sense that B's primary recourse is against the original asset in which his equitable estate still survives. B's rights to the original asset and to the substitute are alternative and inconsistent with each other. Accordingly, when B elects to enforce his inchoate title to the substituted asset (whether by taking a beneficial interest or by a lien), he bars himself from asserting any proprietary remedy to recover the original asset. He also bars himself from bringing a personal remedy against P in an

[32] Text to n 1–2 above.

[33] On the relevance of election to the enforcement of alternative proprietary interests in different assets, LD Smith, *The Law of Tracing* (OUP Oxford 1997) 380–383.

action for knowing receipt since that claim also depends on B's proving that P received an asset to which B had a subsisting equitable right.

On the other hand, with an authorized disposition of trust property which overreaches B's interest to the proceeds of the sale, B has no election to make. His only proprietary claim can be to the proceeds since his interest in the original asset was automatically transposed to them by the overreaching transaction. B cannot elect to claim back the original asset since T validly extinguished B's title to it when he sold it to P.

## D ADOPTION OF UNAUTHORIZED INVESTMENTS

This part considers the connection between the cases where B decides to adopt an unauthorized investment of trust money and those where B elects to enforce his title to a substituted asset acquired in an unauthorized exchange. If, in the latter case, B opts to take a beneficial interest in the substitute, is that any different from saying that he has adopted the unauthorized exchange? The same question can be put the other way around. What, if anything, does B get by adopting an asset acquired in an unauthorized exchange that he would not have got if he had elected to enforce his inchoate title to it by taking a beneficial interest?

As was discussed in the previous part, the beneficiaries of a trust may adopt an unauthorized investment of trust money provided that they are all *sui juris* and agree to the adoption.[34] This would be to their advantage if the investment turned out to be profitable and showed good future prospects. The view argued for here is that this course is barely different in substance from what happens if B elects to enforce his inchoate title to that unauthorized investment by claiming a beneficial interest in it. The results are similar even though the mechanisms to achieve them may differ.

The main difference between the two mechanisms is that with a genuine adoption of an unauthorized exchange, overreaching would come into play. When B adopted the substitute, he would retroactively confer on T the authority to enter into the transaction in which the asset was acquired. It would thereby be treated as an authorized disposition, with the consequence that T would retroactively be authorized to overreach B's beneficial interest in the original asset. B's title to the original asset would be transposed to the substitute. Overreaching would extinguish entirely B's title to the original asset, and with

[34] Cases in n 29 above. We tend to speak of B adopting an unauthorized investment, rather than tracing into it, where T acquired it by a straight substitution of B's trust money for the investment, rather than in exchange partly for B's money and partly for his own. Adoption may also seem the more natural description of B's decision to claim the substituted asset where T intended all along to hold the substituted asset on behalf of the trust, rather than to claim it wrongfully for his own benefit. In the cases of a claim to a mixed substituted asset or to an asset which T wrongfully acquired for his own benefit, it seems more natural to speak of B tracing into and asserting a proprietary remedy over the asset, than adopting it for the trust.

it any right of action that B might have had against P. Even if P could not claim to be a bona fide purchaser of the original asset, he would, in principle, be immune to any proprietary claim by B.

Having said that, it is easy to make too much of the significance of adoption in causing overreaching to extinguish B's title to the original asset now transferred to P. It is true that if B did not adopt, but simply elected to claim a beneficial share in the unauthorized substitute, there would be no possibility of any retroactive overreaching which would extinguish B's title to the original asset when T transferred it to P. But if B is irrevocably barred from enforcing any claim to the original asset transferred to P, then P's title is effectively good against all the world. It is unreal to suppose that B still has some subsisting property interest in the original asset now in P's hands since he would never get a remedy to enforce it. From P's point of view, the effects of overreaching or of B's election to claim the substitute are the same.[35]

The similarities between the adoption of an unauthorized exchange and the election to claim an interest in a substitute go further. Whichever course B opts for, he may still seek to recover equitable compensation from T for any residual losses that B may suffer owing to T's breach of trust in making the unauthorized exchange. So if B claimed a lien or beneficial share over the substitute acquired in the unauthorized exchange but that was still not enough to make good the full amount of his loss, B could sue for the difference on a personal claim for breach of trust. Assertion of the proprietary claim would not bar the personal claim for losses resulting from the breach of trust. The two claims would only be inconsistent if running them together caused B to recover more than the amount of his loss. In effect, B would assert a proprietary claim to the substitute in part satisfaction of his personal claim against T for breach of trust.[36]

Correspondingly, B should, in principle, be able to sue for any further losses resulting from the breach of trust even after he has adopted the asset acquired in the unauthorized exchange. B may adopt the exchange transaction without also waiving his right to sue T for breach of trust, provided that the value of the asset adopted does not exceed the amount of B's losses resulting from the breach. A transaction where T exchanges an original asset in breach of trust has two main aspects to it. The first is the effect of the transaction on the property

[35] See *Marsh v Keating* (1834) Bing NC 198, 131 ER 1094, a decision on the analogous position at common law. The plaintiff's agent wrongfully sold her stock. She elected to sue for the money proceeds of the stock. Park J delivered the opinion on behalf of the House of Lords. He held that the plaintiff could not ratify the agent's wrongful disposition of the stock—it was impossible to ratify an act which amounted to a felony—but that in electing to claim the proceeds she was barred from asserting any title to the original stock. The purchaser's title to the stock was effectively good against the whole world. The title of the original owner, though in theory stronger, was rendered unenforceable by her election to sue for the money proceeds. The purchaser's "right to the stock would be so far collaterally and incidentally strengthened" by the fact that the original owner was barred from asserting a competing claim to it: *Marsh v Keating*, 217 (Park J).

[36] If T is insolvent, it may be practically worthless for B to make the personal claim against T as well as a proprietary claim against T's assets. But that practical problem does not mean that the two claims could not, in principle, be run together.

rights of B and P in the assets exchanged. The second is the liability of T to B for acting in breach of trust. B may adopt the transaction so as to confer on T the necessary authority to deal with P. This would ensure that overreaching happened, with P taking a clear title to the original asset and B getting an equivalent interest in the substituted asset. However, in adopting this transaction with P, B would not necessarily waive his separate right to sue T for any losses resulting from the breach of trust. It is not the case that adoption of one part of the transaction makes it authorized for all purposes, including the liability of T to B.

The analogy is with the contract cases where an agent exceeds his principal's authority by entering into an unauthorized contract of sale with a third person. Here it has been accepted that the principal can ratify the contract with the third party (it may be in the principal's commercial interests to do this), without also waiving his right to sue the agent for losses resulting from the breach of the agency agreement.[37] Indeed, this distinction between affirming a colourable transaction, and giving up the right to sue those who wrongfully brought about the transaction, has been recognized in statute. So, for example, it is often possible for a company to ratify a transaction which its directors caused in breach of their duties, while retaining rights of action against the wrongdoing directors.[38]

*Re Lake*,[39] a decision of Wright J, is direct authority that this approach applies when B adopts an unauthorized investment of trust money. In breach of trust, the trust solicitors invested £5,500 of trust money in a contributory mortgage. The mortgagor later claimed to have the mortgage set aside for fraud. The trustees agreed to compromise the mortgagor's claim in return for a payment of £500. In later litigation, Wright J held that the trustees' entering into the compromise agreement amounted to an adoption of the unauthorized investment in the mortgage. However, he held that this did not bar the trust from proving against the estate of the bankrupt surviving trustee to recover the difference

[37] FMB Reynolds (ed) *Bowstead and Reynolds on Agency*, (16th edn Sweet and Maxwell London 1996) 98; *Mineworkers' Union v Brodrick* 1948 (4) SALR 959; and *Suncorp Insurance and Finance v Milano Assicuranzioni SPA* [1993] 2 Lloyd's Rep 225, 235 (Waller J).

[38] For example, Companies Act 1985 ss 322, 322A.

[39] [1903] 1 KB 439. To the contrary is the sparsely reported decision of Wood V-C in *Thornton v Stokill* (1855) 1 Jur NS 751. The beneficiaries were held to have a strict election between either claiming the houses in which £400 of trust money had wrongfully been invested, or recovering the losses resulting from the wrongful investment. They could not claim the houses as well as the difference between the value of the houses and the £400 misapplied. DJ Hayton, *Underhill and Hayton's Law of Trusts and Trustees* (15th edn Butterworths London 1995) 846, n 19 proposes a compromise to circumvent the result in *Thornton v Stokill*. B should make clear that he is only taking the substituted asset in part satisfaction of his personal claim for breach of trust, but that he does not intend to adopt T's breach of trust. In my opinion, it would be more straightforward just to apply the analogy from the contract cases. So long as B does not recover more than his total loss, there should be no objection to adopting the transaction for the limited purpose of claiming the substituted asset and suing T for any remaining losses resulting from his breach of trust.

between the £5,500 lost in the unauthorized investment in the mortgage and the £500 recovered by adopting the mortgage.

## E CONCLUSION

The doctrine of overreaching and B's right to trace into and enforce his title to the proceeds of an unauthorized sale of trust property are both mechanisms which allow B to assert a proprietary interest in the substitute for an original trust asset. They allow the trust fund to continue as a fluid, fluctuating entity even though T has altered the composition of the fund by disposing of an asset within it and getting another in exchange. Both doctrines take effect by operation of law, which prevents the need to have a fresh express re-settlement of the trust property every time a new asset is acquired. Since both doctrines confer on B a title which is essentially proprietary in character, they preserve B's status as a secured creditor of T even though the assets in the fund which T manages for B may be constantly fluctuating.

There are, however, differences between B's rights acquired through overreaching and the corresponding rights acquired when T exchanges B's original trust asset without authority. The main incident of B's title to the product of the unauthorized exchange is that it gives him a right to elect between claiming a lien or a beneficial interest in the substitute, while, in the case of an authorized exchange, B immediately gets an interest in the substitute which is equivalent to the one he had in the original asset. The two kinds of right may differ in the extent to which they can be enforced in priority to other competing claims to the same asset.

Of much more significance, however, is the difference between B's rights against P in cases of dispositions which are retrospectively authorized and unauthorized. With an authorized disposition the effect of overreaching means that B's rights to the original asset are necessarily extinguished. However, with an unauthorized disposition of a trust asset to P, B may sometimes have the option of enforcing his original title to that asset in the hands of P.

# 5

# *Transfers*

LIONEL SMITH

## A INTRODUCTION

A COMMON BREACH of trust involves a transfer of property contrary to the terms of the trust. The goal of this Chapter is to understand the status of property so transferred, in the hands of the transferee. Take the typical case of a trustee who holds property on an express trust, and transfers it to someone who knows about the trust. Most of the books say that the transferee holds the property on constructive trust.[1] This suggests that it is a new trust, different from the express trust on which the property was held before the transfer. But if we understand the beneficiary under a trust to hold proprietary rights in the trust property, we will find it easier to say that these pre-existing rights subsist, just as we would in the case where I lose my watch and a defendant finds it. On this view, the proprietary rights of the beneficiary are just those which she held before the transfer, which arose on the creation of the express trust. Maudsley said:

> In some [constructive trusts, the beneficiary's interest] can amount to full beneficial ownership; if that is the case, then a full and complete trust exists, as for example where trust property is conveyed to a purchaser with notice. Such a transferee is under the same duties as the earlier trustee was; and such a trust is matter for the law of trusts.[2]

But we must be careful about saying that the express trust simply survives, the transferee now taking the place of the original trustee. The express trustee might have held discretionary powers, say a power of appointment, under the terms of the trust deed. We would not expect that this power should pass to the transferee. Nor is it clear that duties such as those of investment and insurance properly fall on the transferee, particularly when we consider that the trust interest will subsist against a purely innocent transferee, if he did not give value.

[1] JE Martin *Hanbury & Martin Modern Equity* (15th edn Sweet & Maxwell London 1997) 298–303; AJ Oakley *Parker and Mellows: The Modern Law of Trusts* (7th edn Sweet & Maxwell London 1998) 336–339; JG Riddall *The Law of Trusts* (5th edn Butterworths London 1996) 434 (but see *The Law of Trusts*, 446–451, noting many of the points which are discussed in this Chapter).

[2] RH Maudsley "Proprietary Remedies for the Recovery of Money" (1959) 75 LQR 234, 236–237. He went on to speculate whether some trusts were merely remedial, and so perhaps not "matter for the law of trusts."

What turns on this terminological question? Does it matter what we call the recipient, so long as we all agree that the plaintiff's interest subsists? It seems that it does matter, on at least two levels. One is the practical level. Matters such as limitation periods and formalities can turn on whether someone is a constructive trustee or an express trustee.[3] The deeper level on which these things matter is that it sheds some light on the continuing relevance in the modern world of the modes of juridical analysis which, historically, were peculiar to equity.[4] If someone steals my watch, our conceptual framework is simply that my rights, whatever they may be, are unaffected. No one is a constructive anything. And yet the traditional language of equity does not describe the case of transferred trust property in the same way. This Chapter will attempt to expose the logic of the traditional terminology, and ultimately will question whether the terminology currently in use is sufficiently powerful to describe and distinguish all of the relevant ideas in play.

## B PROPERTY RIGHTS AND THIRD PARTIES

This section will consider the modes by which third parties can be affected by pre-existing rights. It will argue that there are two such modes, analytically distinct; the next section will argue that that the traditional terminology of equity has tended to obscure the line between them.

### 1 Property Subsists Through Transfer to Third Party

This is the most straightforward mode by which a third party is affected. It is conceptualized in this way: before the third party's involvement, the claimant had some right in some subject matter; even though the subject matter has been transferred to the third party, the claimant's pre-existing right subsists; and the very right, existing all along, is enforceable against that third party. If the pre-existing right is proprietary, then by definition—at least by the definition adopted herein—it is capable of affecting an indefinite class of defendants in this way.

It is part of the burden of this analysis not only to acknowledge that there are other understandings of the word "proprietary," but to provide some reason for the preference expressed here.[5] First, the right must be enforceable against an

[3] See the discussion in *Paragon Finance plc v D B Thakerar & Co (a firm)* [1999] 1 All ER 400 (CA), and the Chapter by William Swadling in this volume.

[4] In other terms, the continuing dialogue between "equity purists" and "equity pragmatists": see L Smith, "Review" (1996) 75 Can Bar Rev 388; cf J Hackney "Review" (2001) 117 LQR 150.

[5] The preference expressed herein follows WW Cook (ed) WN Hohfeld *Fundamental Legal Conceptions* (Greenwood Press Westport Conn 1978), although I use "proprietary" where Hohfeld used "multital."

indefinite class of defendants, but it need not be enforceable against absolutely everyone. We would not properly deny the label "proprietary" to some right only because it was subject to some version of the defence of good faith purchase, existing to protect reliance on transactional security.[6] Similarly, we can notice that if a right is proprietary, it follows fairly reliably that it gives priority in insolvency, and vice versa*;* but this is not an irresistible inference in either direction.[7] Secondly, the specific enforceability of a right is not useful as an indicator of its proprietary character.[8] In the common law, a right to payment of an agreed sum of money is specifically enforceable as of right, but it would be difficult to defend calling it proprietary if only one debtor is liable. Similarly, take the case of a contractual right to a service, such as snow removal. This contractual right, enforceable only against the promisor, could not properly be called proprietary just because specific enforcement was available.[9] The inadequacy of characterizing by remedial consequences is clearer when we remember that the common law grants no right of specific recovery for moveable things.[10] It could hardly be said to follow that the common law does not recognize proprietary rights in moveable things.

If the claimant's proprietary right survives a transfer of its subject matter to the defendant, there are several conceptual structures for giving effect to the

[6] On the other hand, if we can make a closed list of the people against whom a right prevails, it is effectively a joint obligation: Hohfeld (n 5 above) 72.

[7] The promotion of some personal rights in insolvencies is a common phenomenon. In the UK they are promoted above the proprietary rights of a floating chargee: Insolvency Act 1986 ss 40(2), 175(2)(b); Companies Act 1985 s 196. Conversely, it is equally possible that a right might be enforceable against an indefinite class of persons, but still not against an insolvency officer. See eg, Civil Code of Quebec, art 1496; BGB §816(1) sentence 2. In most common law systems, it is possible to have an unperfected security right which will be ineffective in an insolvency, but which nonetheless can operate against at least some transferees. For example, in the UK a charge which is registrable but not registered under the Companies Act 1985 is void against a liquidator of the debtor company (s 395(1)), but may be enforceable against transferees of charged assets *(Stroud Architectural Services Ltd v John Laing Construction Ltd* [1994] 2 BCLC 276, [1994] BCC 18 (QBD)).

[8] This is therefore inconsistent with the argument, which has been enormously influential in the US, in G Calabresi and DA Melamed "Property Rules, Liability Rules, and Inalienability: One View of the Cathedral" (1972) 85 Harv LR 1089. The authors suggest that any interest enforceable specifically is protected by a "property rule," whereas an interest sanctioned only by a right to compensation is protected by a "liability rule." The analysis is flawed in omitting the protection of some interests by a right to disgorgement of the defendant's gain. More seriously, it tends to the conclusion, deprecated in the text, that an interest is properly called "proprietary" just in case it is specifically enforceable.

[9] The fallacy of equating the availability of specific enforceability with proprietary character is noted by W Swadling "Property" ch 4 in P Birks (ed) *English Private Law* (Oxford University Press Oxford 2000) 212 with reference to the dissenting judgment of Russell LJ in *National Provincial Bank v Hastings Car Mart Ltd* [1964] Ch 665, 695–696, [1964] 2 WLR 751, which dissent was endorsed when an appeal was allowed *sub nom National Provincial Bank v Ainsworth* [1965] AC 1175, [1965] 3 WLR 1 (HL).

[10] Courts of equity always had a discretion to make such an order, and the same discretion was extended to the courts of common law by the Common Law Procedure Act 1854 s 78; see now Torts (Interference with Goods) Act 1977 s 3; but it remains true that no plaintiff has a right to such an order: AS Burrows *Remedies for Torts and Breach of Contract* (2nd edn Butterworths London 1993) 452–456.

right. The law might categorize the defendant as a wrongdoer, possibly insisting on some level of awareness of the claimant's proprietary right. The wrongdoing will generate an obligation, possibly even a trust if it is profitable wrongdoing. Alternatively or additionally, the mere fact that the defendant possesses the subject matter of the claimant's right may oblige the defendant to transfer it to the claimant, without any need to characterize the defendant as a wrongdoer.[11]

## 2 Wrongful Interference in the Absence of Transfer

Another mode by which third parties may be affected by pre-existing rights is by wrongful interference with those rights, in the absence of any transfer to the third party of something which is the subject matter of the claimant's proprietary rights. There is some potential conceptual overlap with the last category: there we saw that a transferee of an asset may be characterized as a wrongdoer. Here we are merely observing that the same characterization may apply even where the subject matter of the claimant's right is in no sense transferred to the third party. In that the previous category supposes a transfer of the subject matter of the claimant's proprietary right, and this category supposes no such transfer, the overlap is excluded. A clear case of wrongful interference without transfer is wrongful damage to tangible property, as where somebody scratches my car with a key. The law counts him as a wrongdoer for this violation of my proprietary rights, and an obligation is generated.

But, I will argue, the same conceptual model can apply in less obvious cases, and equally serves as an example of third parties being affected by proprietary rights; and, that it has something to tell us about property transferred in breach of trust. My starting point will be the tort of inducing breach of contract.[12] The claimant has a contract with someone; the third party becomes liable to the plain-

[11] On one view, the fact of possessing another's thing generates an obligation to return it: P Birks "Misnomer" in W Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Oxford 1998) 1, 22–24. On another view, following Hohfeld, the obligation is just a particularized statement, as it applies to the particular defendant, of the pre-existing property right: Hohfeld (n 5 above) 91–101; RB Grantham and CEF Rickett *Enrichment and Restitution in New Zealand* (Hart Oxford 2000) 34. On this view the obligation is generated by that which generated the proprietary right. An obligation might also be said to arise from unjust enrichment; this is controversial. Here and throughout the Chapter, I omit the case of liability in unjust enrichment. I am concerned with cases in which the third party has received from someone other than the claimant, and my own view is that in such a case there can generally be no such liability because there is no nexus of transfer from claimant to defendant. See *Portman BS v Hamlyn Taylor Neck* [1998] 4 All ER 202 (CA); for a full argument, L Smith "Unjust Enrichment, Property and the Structure of Trusts" (2000) 116 LQR 412; rebuttal by Peter Birks in this volume Ch 7.

[12] *Lumley v Gye* (1853) 2 E & B 216, 118 ER 749 (KB), Simpsonized by SM Waddams, lightly in "Breach of Contract and the Concept of Wrongdoing" (2000) 12 SCLR (2d) 1, 24–26, and thoroughly in "Johanna Wagner and the Rival Opera Houses" (2001) 117 LQR 431.

tiff by inducing a breach of that contract.[13] While we see a contract as the paradigm example of a right which is personal and not proprietary, this tort liability seems to require us to reconsider. We can observe that there is no logical requirement to admit of such a wrong. If we were adamant about the distinction between personal and proprietary rights, we might well say that for a breach of a personal right, only one person, the one who owed the obligation, can be answerable. Once we have such a wrong, however, third parties are affected by the personal rights and obligations of others. Anyone with a contract right has with it a kind of proprietary right. This is how Blackstone understood the claim which a master had against anyone who enticed away his servant, or who rendered the servant unfit to serve:

To the relation between *master* and *servant,* and the rights accruing therefrom, there are two species of injuries incident. The one is, retaining a man's hired servant before his time is expired; the other is beating or confining him in such a manner that he is not able to perform his work. . . . The other point of injury, is that of beating, confining, or disabling a man's servant, which depends upon the same principle as the last [that is, contracting with a servant already under contract to the plaintiff]; *viz.* the property which the master has by his contract acquired in the labour of the servant.[14]

Nor was this analysis confined to Blackstone. When he wrote the *Commentaries,* this tort liability was confined to interference with master-servant relationships, and with some familial relationships.[15] *Lumley v Gye*[16] controversially broke new ground by applying it to contracts generally. After this development had been secured in 1881,[17] a seemingly sceptical Sir William Anson said:

This decision settled a question which, despite the case of *Lumley v Gye,* must be considered to have remained open till 1881. The parties to a contract enjoy rights *in rem* as well as rights *in personam*. The obligation binds the parties; the duty to respect the contractual tie rests upon all the world.[18]

[13] More recently, some cases have suggested that the third party can be liable for interference even if it does not actually lead to a breach: *Torquay Hotel Co v Cousins* [1969] 2 Ch 106, [1969] 2 WLR 289, [1969] 1 All ER 522 (CA); this is questionable, on the basis that it would too easily generate a legal recourse for causing purely economic harm: T Weir *Economic Torts* (Clarendon Press Oxford 1997) 37–43.

[14] W Blackstone *Commentaries on the Laws of England* (E Christian (ed) 15th edn Cadell & Davies London 1809) vol III 142 (emphasis in original).

[15] Such as the seduction of a wife or a ward: n 14 above 140–141; JH Baker *An Introduction to English Legal History* (3rd edn Butterworths London 1990) 518–520. The claim by a master in respect of the enticement of his servant is ancient; it is generally thought to be sourced in the Ordinance of Labourers of 1349: Baker 517.

[16] Above n 12.

[17] In *Bowen v Hall* (1881) 6 QBD 333 (CA).

[18] Sir W Anson, *Principles of the English Law of Contract and of Agency in its Relation to Contract* (8th edn Stevens & Sons London 1898) 227. This passage appears in a section called "A man cannot incur liabilities from a contract to which he was not a party." Anson (226) explains his terminology thus: "I speak of duty as that necessity which rests upon all alike to respect the rights which the law sanctions; and reserve the term obligation for the special tie which binds together definite, assignable members of the community." Waddams in "Johanna Wagner and the Rival Opera

On the definition posited above, these statements are accurate. I have a proprietary right (or a right *in rem)* in my contractual rights, because I have a right against an indefinite class of people that they shall not interfere with those contractual rights.[19] As Anson stressed, this does not make my right to contractual performance into a proprietary right; no one but my contractual counterparty is obliged to render performance. The content of the proprietary right to be free of interference (and the obligations which correspond to it) is different from the content of the contractual right to performance.

Even with this distinction made, some might question whether it makes sense to say that everyone holds proprietary rights in their contract rights.[20] We can immediately notice that it would be possible to refine the definition of "proprietary right" to exclude this case. We could say that a right is not properly called proprietary unless, in addition to operating against an indefinite class of people, it has the further characteristic that it is capable of producing legal effects in the absence of wrongdoing. For example, a right of ownership may allow a claimant to vindicate her ownership of the owned thing, without any allegation of wrongdoing against the defendant. Rights dependent on wrongdoing, we might say, are not properly called proprietary.[21] We might argue that they are

Houses" (n 12 above) cites the first edition of Anson, published in 1879 before *Bowen v Hall;* there Anson, while circumspect, seems even more doubtful of the correctness of *Lumley.*

I clarify here that in this Chapter, although I am conscious of the historical complications, I treat "*in rem*" as a synonym for "proprietary" and "*in personam*" as a synonym for "personal."

[19] The precise contours of the liability are immaterial at this point of the analysis, although they are very important in terms of the shape of the law: see generally Weir (n 13 above). In particular, the scope of liability is very much affected by the decision as to what mental state may be required on the part of the defendant. Another important point is that liability may be excluded, explicitly or implicitly, by any regime which requires registration of proprietary rights; the omission of such registration may not only negate the enforceability of proprietary rights as such, but also liability for interference with a contract relating to their subject matter. The point in the text is that only if there were *never* liability for interference with contracts could we say that a contract creates only personal rights.

[20] Some might also doubt whether a proprietary right can have, as its subject matter, a personal right. This point is sometimes made by those who question whether it makes sense to say that trust beneficiaries hold proprietary rights in trust property, since the trust property may be a personal right held by the trustee (as, for example, a bank account). See eg, G Gretton "Trusts Without Equity" (2000) 49 ICLQ 599, 607 n 43: "it could hardly be that the rights of the beneficiaries are real while those of the trustee are personal"; cf P Lepaulle *Traité théorique et pratique des trusts en droit interne, en droit fiscale et en droit internationale* (Rousseau et Cie Paris 1931) 25: "Comment le droit du cestui serait-il dans son essence un droit réel alors que la «res» peut être un droit personnel? Un droit réel sur un droit personnel, quelle logomachie!" (my translation: "How could the beneficiary's right be truly a real right when the trust *res* can be a personal right? A real right in a personal right, what a logomachy!") But at a practical level, any system which allows real security interests in accounts receivable has already come to terms with this; and at a theoretical level, the subject matter of a real right is nothing more than a kind of organizing theme; it can be entirely abstract, as the case of a patent demonstrates. See L Smith *The Law of Tracing* (Clarendon Press Oxford 1997) 50–51, 61–63.

[21] G Gretton "Trusts Without Equity" (2000) 49 ICLQ 599, 602: "It does not follow that a right is real [as opposed to personal] merely because the holder of that right can claim the protection of the law against interference by third parties." See also Gretton, 605 n 38. The argument in the text, however, is that even though a civilian might not call such a right real, it is nonetheless proprietary in the sense advanced here; and moreover, the sense advanced here is not trivial.

merely the obverse of everyone's obligation to act lawfully. I have an interest in my bodily integrity which is protected by the law of wrongs, for example the tort of battery; it would be strained to say, as a result, that I have a proprietary right in my bodily integrity. Here we have worked around to noticing that some rights, even though proprietary inasmuch as they prevail against most everyone, are also *held by* most everyone. Hart called these "general rights"; Birks calls them "superstructural rights."[22] We might say that they are proprietary only in a trivial way. But the case of inducing breach of contract is not like that. If I have a contract, I have a right which no one else has; a unique patrimonial asset. My proprietary right that no one should interfere with this particular contract is not a general right, any more than my ownership of my watch is a general right, even though we all have a right to be free from interference with the things we own.[23] Once we realize that I have a right, operative against most everyone, which is not a general right, it is harder to resist calling it proprietary. This is so even if the right only comes into view through wrongful infringement of it. Assume a legal system allowed people to own moveable things, but did not recognize any claim in respect of such things of the form, "that is mine." It only recognized claims of the form, "you have committed a wrong by interfering with my thing." We could still say, in such a system, that people had proprietary rights in their movable things. And the point is not academic, since the common law of England, Wales, and Northern Ireland appears to be such a system.[24]

So unless we want to say there are no proprietary rights in movable things in England, we cannot disqualify a right from being proprietary merely because it is protected only by the law of wrongs. We might then seize on another point of distinction between, say, ownership of a watch, and the kind of proprietary right in contracts which arises when we have a tort of inducing breach of contract. The former can give priority in insolvency, but clearly the latter cannot. How does ownership of a watch ensure priority in insolvency, in a system which protects ownership via the law of wrongs? By making the insolvency officer potentially liable for wrongdoing, if the watch be not surrendered.[25] This would

22 HLA Hart "Are There Any Natural Rights?" (1955) 64 Phil Rev 175; P Birks (ed) *English Private Law* (Oxford University Press Oxford 2000) xxxviii n 3.

23 For discussion of this point see L Smith (n 20 above) 52–54.

24 This observation applies particularly to these jurisdictions in the light of their abolition of detinue (Torts (Interference With Goods) Act 1978, s 2(1)); although detinue is in some sense a tort, it is also in some sense a direct assertion of ownership. See *General and Finance Facilities Ltd v Cook's Cars (Romford) Ltd* [1963] 1 WLR 644, 650, [1963] 2 All ER 314 (CA): ". . . the action in detinue partakes of the nature of an action *in rem* in which the plaintiff seeks specific restitution of his chattel." (Diplock LJ). The question whether common law proprietary rights in moveable things are protected solely by the law of wrongs is further complicated by the availability of a declaration in respect of legal rights, and also by the use of the action for money had and received in a role like that of detinue: see *Agip (Africa) Ltd v Jackson* [1990] 1 Ch 265, 287–288, [1989] 3 WLR 1367, [1992] 4 All ER 385 (ChD); aff'd without discussion of this point, [1991] Ch 547, [1991] 3 WLR 116, [1992] 4 All ER 451 (CA).

25 *Lipe Ltd v Leyland DAF Ltd (in administrative receivership)* [1994] 1 BCLC 84, [1993] BCC 385 (CA).

not work for a contract right; an insolvency officer could not be made personally liable for inducing breach of contract, even if the decision not to perform was made by him. Standing in the shoes of the insolvent person, he has the power to terminate that person's contracts in a way which does not satisfy the elements of the tort (just as a solvent party to a contract does not commit the tort when he decides to breach the contract, nor when he goes ahead and breaches it). In a similar way, an employee who brings about a breach of his employer's contract in good faith does not commit the tort.[26] But those are merely the contours of the wrong. We have already seen that it is appropriate to designate a right as proprietary if it avails against an indefinite class of persons; it need not avail against everyone, and in particular it need not give priority in insolvency.[27]

## 3 Conclusion

The conclusion of this rather abstract introduction is this. If one has a right which operates against an indefinite class of people, it is appropriate to call that right proprietary or *in rem*. No one can dictate terminology, and some might say that this definition casts the net too widely; in particular, it leads us to say that I have a proprietary right in my contract rights. One might object to that terminological choice on the ground that there is no protection of that right save through the law of wrongs; but then it appears that one is committed to the position that English law knows no proprietary rights in moveable things. Another might object to the choice on the ground that this allows proprietary rights which do not give a priority in insolvency; but then one is committed to the position that a registrable but unregistered charge is not proprietary, even though it can operate against transferees of the charged asset.[28] But the defence of my terminological preference is not central to my argument; so long as it is understood, the argument can be laid out.

In particular, the following points are crucial to my argument. In the sections above, I set out two different ways of understanding how a third party can be affected by the claimant's right: "Property Subsists Through Transfer to Third Party" and "Wrongful Interference in the Absence of Transfer." I argued that third party effects in both situations are evidence of proprietary rights held by the claimant.[29] But there are still three important differences between the two categories, all of which were noticed above. (1) The second conceptual frame-

[26] *Said v Butt* [1920] 3 KB 497; applied to corporate managers in the context of a controversial extension of their personal liabilities in *ADGA Systems International Ltd v Valcom Ltd* (1999) 43 OR (3d) 101, 168 DLR (4th) 351 (CA); leave to appeal denied 6 April 2000 (SCC).

[27] Text at nn 6–7.

[28] Above n 7.

[29] Nor should this be any surprise, since I effectively defined "proprietary" as "operating against third parties."

work works if and only if we can characterize the defendant as a wrongdoer. If the defendant has not obtained anything which counts as the subject matter of the claimant's proprietary right, there is no way to build a liability out of that proprietary right except by finding a wrongful interference with it.[30] By contrast, the first conceptual framework involves a transfer to the defendant of something in which the claimant holds a proprietary right. Here we can understand the defendant to come under an obligation, without the need to find wrongdoing.[31] (2) The second framework, wrongful interference without transfer, works even if the right which was interfered with is purely personal. That is the case of inducing breach of contract: the right to performance operates against one person only; the right to be free of interference is proprietary. The first framework, in contrast, supposes that the defendant has received something in which the claimant has a proprietary right. (3) The first conceptual framework, which sees the defendant taking possession of something in which the plaintiff has a proprietary right, can generate priority in bankruptcy, because the proprietary right of the claimant is enforceable against the insolvency officer. The second conceptual framework does not necessarily do so, since it depends on wrongdoing, and since the insolvency officer will not commit a personal wrong by failing to honour the obligations of the insolvent.

## C EQUITY'S CHOICES

### 1 Uses and Trusts

The development of the use, which bore the trust, is a familiar story. I do not intend to retell it, but only to cast it in the terms I am using in this Chapter. We begin with a transfer of a legal estate in land (a feoffment to uses), to be held by the transferee (feoffee to uses) to the use of the transferor (cestui que use).[32] The use is an obligation in respect of the land. As far as the common law is concerned it is not cognizable, but it is enforceable against the feoffee to uses in another place.[33] No question of whether the right is personal or proprietary arises so long as the only defendant is the promisor, the feoffee to uses. The question arises, however, if feoffee to uses transfers the estate to another, or if

[30] This omits the case of liability in unjust enrichment, which I do not suppose to be built on the claimant's proprietary right, but rather on an abstract enrichment of the defendant at the plaintiff's expense: n 11 above.

[31] Text at n 11.

[32] Early uses were almost uniformly of the form that (in modern terms) the settlor was also the beneficiary for life. This leaves aside such things as uses for the benefit of monastic orders, but for the purposes of this argument nothing turns on this.

[33] Uses were common from the middle of the fourteenth century, which was before the Chancellor enforced them regularly. Their early enforcement, before the second quarter of the fifteenth century, is something of a mystery, but it seems likely that they were enforced in the ecclesiastical courts: R Helmholz "The Early Enforcement of Uses" (1979) 79 Columbia LRev 1503.

feoffee to uses dies, in which case the estate passes by operation of law to his heir-at-law.[34] As Maitland tells the story, enforceability against an heir was straightforward, since this person was only a representative.[35] More creativity was required to enforce the use against a transferee. If the estate was transferred gratuitously, Maitland said, enforcement against the donee shows the beneficiary's right "beginning to look 'real'."[36] The most creativity was required in the case of a transferee for value; here, if the transferee knew or should have known of the transfer, he can be taken to be a kind of wrongdoer, and the enforcement justified on this basis.

I would like to argue for a different understanding. Enforceability of the use against a transferee who had notice is the easiest case conceptually. It fits into the model of "Wrongful Interference in the Absence of Transfer": the same model which now explains the tort of inducing breach of contract. It does not require any understanding that cestui que use has any proprietary right in the land. It only requires a rule that one cannot knowingly interfere with the realization of someone else's right, even where that right is personal. It is the case of enforcement against the heir which is truly revolutionary, because the heir is not a wrongdoer. He merely takes that which the law gives to him as of right, regardless of the wishes of the deceased feoffee to uses. This case caused a great deal anxiety, and rightly so.[37]

Unlike in the case of the transferee with notice, in this case liability entails that cestui que use has a proprietary right in the land.[38] It can only be justified through the model of "Property Subsists Through Transfer to Third Party." Once the step is taken that the heirs of the feoffee to uses cannot take the land for their own benefit, it must also follow that creditors of feoffee to uses cannot have it either.[39] And when the institution of bankruptcy was added by statute, with the trustee in bankruptcy originally in the role of an assignee (not for value) of the assets of the bankrupt, priority in bankruptcy was inevitable.[40]

[34] Since it was impossible to control the devolution of a legal estate before the Statute of Wills 1540. In practice the problem was generally avoided by having multiple feoffees to uses who held the estate jointly.

[35] FW Maitland *Equity* (revised by J Brunyate) (Cambridge University Press Cambridge 1909 repr 1929) 84–85, 117; see also JL Barton "The Medieval Use" (1965) 81 LQR 562, 570.

[36] Maitland (n 35 above) 118. The donee is a "purchaser": one who takes other than by operation of law (C Harpum *Megarry and Wade: The Law of Real Property* (6th edn Sweet and Maxwell London 2000) 46–47, 139); but he is not a purchaser for value.

[37] R Helmholz "The Early Enforcement of Uses" (1979) 79 Columbia LRev 1503, 1509 says that there is no evidence whether the ecclesiastical courts enforced the use in such a case. AWB Simpson *A History of the Land Law* (2nd edn Clarendon Press Oxford 1986) 180, suggests greater hesitation in enforcing uses against an heir than against a transferee with notice.

[38] The same is true of the case of the donee without notice, since such a person has also not interfered wrongfully. Presumably this was rarer, and subject to healthy scepticism as to the lack of notice; but once the heir was bound regardless of notice, it must follow that a donee was in the same position.

[39] Though this step was taken with some difficulty: Maitland (n 35 above) 117.

[40] Indeed, contrary to the usual mythology that trusts were not cognizable in the courts of common law, those courts took notice of trusts in bankruptcy and held that property held in trust by the bankrupt did not pass to the assignee: L Smith "Tracing in *Taylor v Plumer*: Equity in the Court of King's Bench" [1995] LMCLQ 240. This result is now confirmed by statute (eg, Insolvency Act 1986

I am far from suggesting that this conceptual step, which effectively granted a proprietary right in the land to cestui que use, was taken in those terms (though it is significant that the step was taken only with hesitation).[41] I only mean that it marks a move from my second model to my first. The step from one model to the other does not seem so great if we see that in each case there is a transfer of the land to the defendant, and the question is simply whether the transferee is to be allowed to enjoy the land or not. In each case the answer is no, the defendant is not allowed to do that; he is not allowed to upset the arrangements made earlier in relation to the land. But once we move beyond the case of someone who is a wrongdoer, the only way to support liability on the part of a transferee is by a proprietary right.[42]

If the right of cestui que use is truly personal, then it has no subject matter, and therefore the mere receipt by someone of some subject matter cannot make that person liable in respect of that right. This brings into focus another point. The move from the second model to the first is only possible in respect of some kinds of rights. If someone owes me $50, no money which he has, no money in the world, is the subject matter of that right. It therefore seems impossible, even if we wanted to, to shift my personal right into a proprietary one which will bind a third party. In the absence of some wrongdoing, such as inducing breach of contract, there is no link between claimant and defendant. If someone owes me an obligation to transfer to me a specific horse, we may choose to differentiate this from the case of the debt by saying that it is a *jus in personam ad rem:* a personal right which relates to a particular thing.[43] But if we really mean that it is personal, we do not mean by this label to say that I have any right in the horse.[44] We merely subdivide personal rights into (a) those whose performance involves no particular thing, and (b) those whose performance does. Conversely, if someone who succeeds to the horse owes me an obligation in the absence of any wrongdoing,[45] it must be the case that I do have a right in the horse: my right is not purely personal. There is no other way to explain the obligation. So

s 283(3)(a)). The common law courts were early on required to take notice of uses by a statute of 1484 which allowed cestui que use to convey what he did not hold, the legal estate: Baker (n 15 above) 287. For an example of interaction occurring even before that, see n 94 below.

41 It is also significant that the step was not fully taken; those who did not in some sense claim through the feoffee to uses were not bound. A lord who took the land by escheat was not bound until 1834, and then by statute: Lord Nottingham *Prolegomena of Chancery and Equity* in DEC Yale (ed) *Lord Nottingham's Two Treatises* (Cambridge University Press Cambridge 1965) ch XIV §1; Maitland (n 35 above) 120. A squatter was also traditionally not bound, although a different result was reached in *Re Nisbet and Potts' Contract* [1906] 1 Ch 386 (CA); Maitland (121, 169–70) was not impressed. Simpson (n 37 above) 181, commenting on these exceptions, says the use "never came to bind the land itself." And, although by statute (n 40 above) cestui que use could convey the legal estate, the common law courts took a narrow view of the effects of the use on common law rights: *Dod v Chyttynden* (1502) 116 SS 395, 407 (cestui que use had no right of distraint for damage feasant).

42 While a non-wrongdoer can be liable in unjust enrichment, my own view is that it is not applicable in these cases: n 11 above.

43 R Goode *Commercial Law* (2nd edn Penguin Harmondsworth 1995) 29–30.

44 Goode (n 43 above) 29–30.

45 And in the absence of any nexus of transfer which would support liability in unjust enrichment.

the thing which is implicated in the performance of some personal rights can be co-opted in a transformation of such rights from personal to proprietary.

The distinction between a *jus in personam ad rem* and a personal right not apt to bear that label therefore plays a crucial role in the story. The move from understanding the enforceability of uses (and hence trusts) by the second model (wrongful interference without transfer), to understanding them by the first model (property subsists through transfer), was only possible because the rights in question were of the type *jus in personam ad rem*. It is possible (whether or not it is advisable is another question, long since settled in this case) to transform a *jus in personam ad rem* into a proprietary right; this is exactly what happened when uses were enforced against heirs. The thing, the land in this case, makes a bridge from claimant to transferee. On the other hand, it seems impossible to transform a personal right which has no particular thing associated with it into a proprietary right, even if we wished to.[46] This remains relevant today. *Space Investments Ltd v CIBC Trust Co (Bahamas) Ltd*[47] is well known for the suggestion of Lord Templeman that if a bank trustee misappropriated trust property, the beneficiaries would have a charge over all the assets of the bank.[48] It seems less well known for the somewhat extraordinary factual configuration which underpins the *ratio decidendi*. A trustee was allowed, by the terms of the trust, to lend itself the trust property. This was done, with the result that the trustee owed a debt to the beneficiaries. There was no longer an asset held by the trustee in trust, just as might be the case in which a trustee wrongfully breached the trust by consuming the trust property in a way which left no traceable proceeds. On the insolvency of the trustee, the beneficiaries sought to establish that the debt owed to them had priority. The holding was that it did not. There was no asset, which had passed into the control of the liquidator, and in relation to which the beneficiaries could say the trustee had owed them an obligation.

So the story of the trust is, effectively, the story of deciding that a *jus in personam ad rem* should be enforceable not only against the debtor but against others. To the extent that those others are wrongdoers, even this is not a technique peculiar to equity, but one shared by the common law and by the civilian tradition. So long as a system will not tolerate wrongful interference with others' obligations, it adds a kind of proprietary right alongside every personal right; but as we have seen, the personal right remains such. Equity offered specific enforcement, of course, which the common law did not, and presumably this could have been deployed against someone who wrongfully interfered with a trustee's obligation; but this on its own would not make a trust as we know it,

[46] This is effectively the holding in *Re Goldcorp Exchange* [1995] 1 AC 74, [1994] 3 WLR 199 (PC NZ).

[47] [1986] 1 WLR 1072 (PC Bahamas).

[48] This is now gravely weakened by *Bishopsgate Investment Management Ltd v Homan* [1995] Ch 211, [1994] 3 WLR 1270 (CA) and *Re Goldcorp Exchange* [1995] 1 AC 74, [1994] 3 WLR 199 (PC NZ).

since it provides no protection on the death or insolvency of the trustee. The use was made, and the *jus in personam ad rem* was transformed into a *jus in rem*, by the decision that those who innocently succeeded to the *res* were bound by the same obligation in relation to that *res* which had bound feoffee to uses.

Except it is probably not quite accurate to say that such a transferee was bound by "the same obligation." This raises another important point about the evolutionary story. Uses were, in modern terms, passive. The feoffee to uses did not have active duties of management, such as investment and insurance; still less did he (or more often they)[49] have discretionary powers. He was like what we would call, today, a bare trustee: holding to the order of cestui que use.[50] In the story which I have told, the transferee (whether for value with notice, or otherwise than for value) is liable for getting in the way of the prior arrangement, the use. To fix that, we say that the transferee is bound by the use. All we really mean is that he is bound not to get in the way. So long as the use was bare, there is no real difference between saying (i) that the transferee is bound by exactly the same use as that which bound the original feoffee to uses, and (ii) that the transferee has only one obligation, specifically enforceable of course, which is not to frustrate the use. We noticed earlier that the tort of inducing breach of contract evidences a proprietary right, but not a proprietary right to performance; just a proprietary right to be free of wrongful interference. So too here. It is easier, far easier, to turn a *jus in personam ad rem* into a proprietary right in the *res* if it is to be, not a proprietary right that binds the transferee just as the original obligor was bound, but rather a negative kind of proprietary right, that the transferee should not frustrate the original obligation.

If one were starting with any system which involved personal and proprietary rights, and trying to create within that system a trust as we know it, one would be faced with a pair of axioms which together create the obstacle. First, one might think, one or the other of the beneficiary or the trustee needs to be the owner of the trust property; and you cannot make the beneficiary the owner, or you will not have a trust. Secondly, whatever a person owns, free of the proprietary rights of others, is potentially available to her creditors and to her heirs, and so you cannot make the trustee the owner either. Just as you cannot make an omelette without breaking eggs, it seems you cannot make a trust without breaking one of these rules. The common law breaks the first one, by making the trustee the owner and at the same time giving the beneficiary a proprietary right. The Quebec trust also works by breaking the first rule, but in a different

[49] Above n 34.
[50] This is why the story is inaccurate that the Statute of Uses 1536, which "executed" uses by transferring the legal estate to cestui que use, was eviscerated by a kind of judicial conspiracy. The story is most famously captured by Lord Hardwicke's dictum that a solemnly enacted statute "had no other effect than to add at most three words to a conveyance" *(Hopkins v Hopkins* (1738) 1 Atk 581, 591, 26 ER 365, 372). It is inaccurate because the uses which were held not to be executed were those which were not, in modern terms, bare trusts, and which were therefore outside the mischief at which the Statute of Uses was aimed. Baker (n 15 above) 329–330.

way: it creates a system in which neither trustee nor beneficiary is owner.[51] The law of Scotland takes a different approach, by breaking the second rule. The trustee owns the property, the beneficiary has no real right, but still the property is not available to creditors, because the trustee holds it in a separate "patrimony" from that which contains his personal assets.[52] That conceptual structure, combined with the possibility of liability for interfering in the performance of another's obligation, can explain a beneficiary's priority in bankruptcy as well as his recourse against transferees with notice.[53] It is arguably possible to understand the common law trust in this way; indeed, this offers some advantages.[54] What I have described as a shift from a model of "wrongful interference in the absence of transfer" to a model of "property subsists through transfer to third party" could be understood as a decision that an asset has moved into a distinct patrimony. I am not sure that much turns on this, certainly for present purposes. On either view, the shift is profound; but I stick to my own understanding partly because even though the shift is profound, this is not so obvious when it is described as I have described it. And I think this is part of the story of how it came about, and is also, as I will try to show below, part of the story of how it continues to come about, or to flirt with coming about. Having started with the trust, where the shift has clearly come about, I will consider six cases, starting closest to the trust—the case where the shift has come about—and moving through four others, ending with a case where it has not.

## 2 Contracts to Transfer Specific Property

If a defendant promises to transfer or create an interest in particular property, we often say this makes a trust. The party who promised to make a transfer is

[51] CCQ art 1261; J Beaulne *Droit des fiducies* (Wilson & Lafleur Montreal 1998). The trustee's powers over the unowned trust property are those generally available to one who manages property which he does not own. It is also possible to make a trust by breaking the first rule in a third way: by saying that perhaps, after all, the beneficiary can be made the owner, so long as we can restrict the powers an owner normally has over his own property. This is the conceptual structure of the Dutch *bewind*, although that institution is available only in particular circumstances: S Kortmann and H Verhagen "National Report for the Netherlands" in DJ Hayton et al (eds) *Principles of European Trust Law* (Kluwer Law International The Hague 1999) 195, 199–200.

[52] G Gretton "Trusts Without Equity" (2000) 49 ICLQ 599. A patrimony is a collection of assets, and, in a wide sense, also of liabilities. In the civilian tradition, every legal person has a patrimony; in many civilian systems, such as the French, every legal person has exactly one patrimony, so excluding the Scots solution. The Quebec trust uses the same concept; the trust property is a "patrimony by appropriation, autonomous and distinct from that of the settlor, trustee or beneficiary and in which none of them has any real right" (CCQ art 1261).

[53] It is not quite so apt to explain the case of the donee; Gretton (n 52 above 602) appeals to the principles of fraudulent conveyances, but this suggests a higher burden on the beneficiary than we may expect in the usual understanding of the trust.

[54] This is the thrust of Gretton's excellent analysis (n 52 above). One advantage of this analysis is that it seems more appropriate for the case of a purpose trust.

said to hold the interest to be transferred on constructive trust for the transferee. The historical root again lies in the law of uses, perhaps by analogy to sales of specific goods, in which title passed at the moment of contract, so protecting the buyer against transferees and creditors of the seller.[55] But what was the warrant for equity to go beyond the law when it came to land? The trigger has always been said to be the specific enforceability of the obligation.[56] But specific enforceability of an obligation does not, as a matter of logic, make a proprietary right.[57] It cannot in some cases, namely those where the obligation does not have a particular subject matter;[58] and it need not, as a matter of logic, in any case. But, where the obligation is a *jus in personam ad rem,* the step can be taken; and so it was here, just as in uses and trusts.

What is the point of this trust? It is clear that it is not really a trust in the sense that all beneficial interest in the asset in question passes to the transferee-to-be at the moment the specifically enforceable promise is made.[59] The core of the doctrine seems to be to give the purchaser a kind of security interest: it makes sure that the purchaser's bargain is enforceable, even in the face of death or insolvency, or a transfer to a third party.[60] In the days of uses, the contract meant that the vendor held the property to the use of the purchaser. This was enough to generate the required security, and not much else.[61] With the coming of the trust, perhaps because of a limited juristic vocabulary, the purchaser's interest was always called a constructive trust. The consequences of this, one might say the costs, have been considerable. They were most thoroughly documented by Waters in 1964.[62] One issue was the time at which the trust arose; it might not be known, at the time of contract, whether the vendor would be able to produce an acceptable title and so whether there would ever be a conveyance.[63] A doctrine of "relation back" was required. This issue is arguably ready to re-surface, as the High Court of Australia and the Supreme Court of Canada have both

[55] JB Ames "The Origin of Uses" in *Lectures on Legal History and Miscellaneous Legal Essays* (Harvard University Press Cambridge Mass 1913) 233, 239.

[56] DWM Waters *The Constructive Trust* (Athlone Press London 1964) 75 says this was regarded as "well established" by 1725. But see S Gardner "Equity, Estate Contracts and the Judicature Acts: *Walsh v Lonsdale* Revisited" (1987) 7 OJLS 60.

[57] Text at n 8.

[58] The contract is generally specifically enforceable by the vendor, but he does not get a trust over the purchase price. Still some judges get carried away, as for example Lord Chelmsford in *Shaw v Foster* (1872) LR 5 HL 321, 333, who said that the purchaser becomes a trustee of the purchase money for the vendor.

[59] C Harpum *Megarry and Wade: The Law of Real Property* (6th edn Sweet and Maxwell London 2000) 678–679; K Gray and SF Gray *Elements of Land Law* (3rd edn Butterworths London 2000) 561–563; AJ Oakley *Parker and Mellows: The Modern Law of Trusts* (7th edn Sweet & Maxwell London 1998) 375; JE Martin *Hanbury and Martin: Modern Equity* (15th edn Sweet & Maxwell London 1997) 314–315.

[60] In *McCreight v Foster* (1870) LR 5 Ch App 604, 610 (LC) aff'd *sub nom Shaw v Foster* (1872) LR 5 HL 321, Lord Hatherley LC said of the vendor: "[h]e has so far, having entered into that agreement, precluded himself from entering into any other contract as to the estate . . ."

[61] *Mareschall's Case* (1506) 116 SS 525; *Ireby v Gibone* (1579) Cary 82, 21 ER 44.

[62] Waters (n 56 above) ch II.

[63] Waters (n 56 above) 76–87.

confirmed that even for interests in land, specific performance is genuinely a matter of judicial discretion.[64] If that is so, then even in this seemingly most "institutional" constructive trust we find a trust which depends on judicial discretion. The doctrine has also generated litigation in relation to the need for formalities.[65] There have been other ramifications, particularly regarding the relationship of this idea to the law of assignment. You can assign the benefit of a contract, but not the burden. Some estates, particularly leases, carry burdens. If A has contracted to grant a legal lease to B, and B assigns to C, is C bound to A by the covenants B made? The general law of assignments says no, but if the agreement to grant a lease is as good in all respects as the grant of a lease, then it seems C should be bound.[66]

So this "trust" was only ever a security interest. In this same context, however, there is another constructive trust, more deserving of the name. This arises if the purchaser has fully performed its side of the contract, and the conveyance has still not occurred. It seems clear that this is an independent principle from that which generates a "constructive trust" on the basis of specific enforceability.[67] This is how a promise to charge after-acquired property is self-executing when the property is acquired; the chargee has already advanced the loan. If the promise was to convey property, then on payment of the price it is held on trust in a fuller sense than that which arises by contract alone, in that the full benefit of the property now accrues to the purchaser. But even here, we can observe that the trust, if it came to be enforced against a transferee from the vendor, would function much like the use enforced against a transferee with notice from feoffee to uses: that is, it is an obligation not to get in the way of the vendor's obligations which relate to the property.[68]

Both of the constructive trusts described in this section, arising from specific enforceability and from full payment of the price, reflect a move from the model of "wrongful interference without transfer," which is known to the common

[64] *Chan v Cresdon Pty Ltd* (1989) 168 CLR 242, para 25; *Semelhago v Paramadevan* [1996] 2 SCR 415, 136 DLR (4th) 1, paras 20–22.

[65] Most recently *Neville v Wilson* [1996] 3 WLR 460 (CA).

[66] This problem has attracted statutory reform in the UK: Landlord and Tenant (Covenants) Act 1995. See also *Chan v Cresdon Pty Ltd* (1989) 168 CLR 242, holding that the guarantor of rent payable under a lease was not liable where the legal lease had not been granted; and generally Waters (n 56 above) 117–125, noting difficulties of interaction with the rule in *Dearle v Hall* (1828) 3 Russ 1, 38 ER 475, litigated in *McCreight v Foster* (1870) LR 5 Ch App 604 (LC), aff'd *sub nom Shaw v Foster* (1872) LR 5 HL 321.

[67] Harpum (n 59 above) 679–680; R Goode *Commercial Law* (2nd edn Penguin Harmondsworth 1995) 676; N Hopkins "Acquiring Property Rights from Uncompleted Sales of Land" (1998) 61 MLR 486, 492–496. Waters (n 56 above) 91 distinguishes three stages of trusteeship, noting that if conveyance occurs before full payment, it is the vendor who retains a security interest in the land, called a vendor's lien (see *Barclays Bank plc v Estates & Commercial Ltd* [1997] 1 WLR 415 (CA)).

[68] Consider *Pullan v Koe* [1913] 1 Ch 9, in which the defendant was treated (under the doctrine of marriage consideration) as having received value for a promise to transfer property to the trustees of an express settlement. The effective holding was that on receipt, she held the property on constructive trust for the benefit of the trustees of the settlement. They of course in turn held that interest on the trusts of the settlement.

law, to the first model "property subsists through transfer." The move is possible because the obligation relates to a specific asset. It amounts to the recognition of a proprietary right in the would-be transferee, although the nature of the right is greater when the purchase price has been paid than when there is only a specifically enforceable contract. Even so, in both cases the content of the trust is entirely passive; the obligation on the trustee must be to hold the property to the order of the beneficiary.

## 3 Contracts Affecting Specific Property

A promise may relate to specific property even though it is not a promise to transfer. Here the position is even messier. There is one kind of case in which, just as in uses and trusts, the promise has been transformed into a right in the land. This is the negative covenant, or the doctrine in *Tulk v Moxhay*.[69] It is interesting to notice two features of the doctrine as it evolved.[70] The first is a clear root in my second model of "wrongful interference without transfer." In the case itself, Cottenham LC essentially understood the claim as one for an injunction to prevent wrongful interference with the performance of a promise.[71] The interference had to be wrongful in the sense that the defendant had to have notice of the promise. But this requirement fell away, showing a clear move to understanding the right as a right in the land; a move to the model of "property subsists through transfer."[72] The conceptual nature of the shift has been addressed above; here we can notice an important practical effect of the shift: the locus of the burden of proof. Even if the claimant has only a personal right against the promisor, there is protection against third parties on the basis of wrongful interference; and this may even be protected by injunction. But the plaintiff must show wrongful interference. Once the right is a right in the land, the burden shifts; prima facie it binds a transferee of the land, unless a defence can be shown.[73]

The other feature of the doctrine, again not found in the roots but only in the evolution, is that it only works for negative covenants.[74] We have already noticed that this is the easiest type of promise to turn into a proprietary right. The

[69] (1848) 2 Ph 774, 41 ER 1143 (LC).

[70] S Gardner "The Proprietary Effect of Contractual Obligations under *Tulk v Moxhay* and *De Mattos v Gibson*" (1982) 98 LQR 209, 293–315.

[71] "That the question does not depend upon whether the covenant runs with the land is evident from this, that if there was a mere agreement and no covenant, this Court would enforce it against a party purchasing with notice of it; for if an equity is attached to the property by the owner, no one purchasing with notice of that equity can stand in a different situation from the party from whom he purchased." (1848) 2 Ph 774, 778, 41 ER 1143, 1143.

[72] Gardner (n 70 above) 311–312.

[73] This effect is clearly stated in this context in *Re Nisbet and Potts' Contract* [1906] 1 Ch 386 (CA).

[74] Gardner (n 70 above) 293–298. It was further restricted by the addition of the requirement that plaintiff have land which benefits by the promise: Gardner (n 70 above) 299–310.

model of "wrongful interference" gives a kind of proprietary right protecting every promise, but it never makes others liable to perform. The promisee is better protected if we shift the promise itself into a proprietary right in the thing to which it relates; but this shift is least objectionable, least jarring, when the proprietary right remains a right to be free from interference with the performance of the promise, rather than a proprietary right to performance itself.

The other line of cases to notice here is that stemming from *De Mattos v Gibson*.[75] The question is whether a promise in relation to some movable thing can affect a transferee of the thing from the promisor, in a way which goes beyond what the common law will provide through the law of tort; in particular, whether an injunction is available. The answer is, sometimes. One case, building expressly on the analogy of *Tulk v Moxhay,* suggested that this reflects the existence of an interest in the thing, by way of a constructive trust.[76] This suggestion has not been well received.[77] Even though this doctrine was born along with *Tulk v Moxhay,* it has not grown up with it. Effectively, we see a choice between models different from the one ultimately made in the *Tulk v Moxhay* line. Here, the conceptual basis of the third party's liability seems to be wrongful interference, without any decision to see the plaintiff as holding a proprietary right in the thing.[78] It is like an injunction not to induce a breach of contract.[79] This does not necessarily mean that the availability of such an injunction corresponds exactly to the scope of that tort;[80] although it may mean that it should.[81] The enforcement is by injunction, but an injunction does not mean the move has been made to the recognition of a proprietary right in the thing transferred.[82]

[75] (1858) 4 De G & J 276, 45 ER 108 (CA in Ch).

[76] *Lord Strathcona SS Co v Dominion Coal Co* [1926] AC 108 (PC Nova Scotia) 125 (Lord Shaw).

[77] *Port Line Ltd v Ben Line Steamers Ltd* [1958] 2 QB 146, [1958] 2 WLR 551 (QBD); Gardner (n 70 above) 286–287; A Tettenborn "Covenants, Privity of Contract, and the Purchaser of Personal Property" (1982) 41 CLJ 58, 71–72; S Worthington, *Proprietary Interests in Commercial Transactions* (Clarendon Press Oxford 1996) 106–107; W Swadling "Property" ch 4 in P Birks (ed) *English Private Law* (Oxford University Press Oxford 2000) 267–268.

[78] Cf Worthington (n 77 above) 108–116, who argues for a position which corresponds to neither of my models.

[79] This was the understanding of Browne-Wilkinson J in *Swiss Bank Corp v Lloyds Bank Ltd* [1979] Ch 548, [1979] 3 WLR 201 (ChD), varied [1980] 3 WLR 457 (CA), affd [1982] AC 584, [1981] 2 WLR 893 (HL). We can also recall that before Lumley succeeded against Gye on the question of whether there was a general tort of inducing breach of contract (*Lumley v Gye* (1853) 2 E & B 216, 118 ER 749 (KB)), he obtained an interlocutory injunction against him (*Lumley v Wagner* (1852) 1 De GM & G 604, 42 ER 687). SM Waddams "Johanna Wagner and the Rival Opera Houses" (2001) 117 LQR 431, 454–456, notes that at trial, Lumley ultimately failed to establish the tort against Gye. The ability of a defendant to demur *and* alternatively to deny essential factual allegations was at that time novel.

[80] Gardner (n 70 above) 292–293; Tettenborn (n 77 above) 82–83; Worthington (n 77 above) 105–106.

[81] J Beatson *Anson's Law of Contract* (27th edn Oxford University Press Oxford 1998) 436. Whatever the state of the relationship between law and equity, it appears that when they are pursuing exactly the same goal, it is at least difficult to justify their having different requirements. See *Canson Enterprises Ltd v Broughton & Co* [1991] 3 SCR 534, 85 DLR (4th) 129; L Smith "Constructive Fiduciaries?" in P Birks *Privacy and Loyalty* (Clarendon Press Oxford 1997) 249, 254.

[82] Above n 8 and text.

One practical effect of staying in the model of wrongful interference is that the claimant's rights, though enforceable against some third parties, cannot achieve priority in insolvency. Another, which comes into focus with the contrast with *Tulk v Moxhay,* is that since the claim is based on wrongful interference with an obligation and not the receipt of something in which the plaintiff has a proprietary right, it is for the claimant to prove that the defendant knew about the obligation with which he is interfering; it is not a case of the defendant's being bound *unless* he can establish the defence of bona fide purchase of a legal estate for value without notice.

We can notice that although the two lines have diverged, they seem to retain one feature in common with one another, shared also by the tort of inducing breach of contract and the enforcement of uses and trusts against heirs, donees, and transferees with notice: conceptually, it is not the case that the transferee succeeds in some way to the obligations of the transferor, the one who was originally obligated to the claimant. Rather, the transferee is enjoined from obstructing the fulfilment of that obligation. Just as covenants enforceable under *Tulk v Moxhay* must be negative, so too any injunction granted pursuant to the *De Mattos v Gibson* line must be.[83] But this similarity in turn highlights another difference between the model of "wrongful interference without transfer" (applying to *De Mattos v Gibson* and the tort of inducing breach of contract) and the model of "property subsists through transfer" (uses, trusts, specifically enforceable contracts to transfer specific property, and *Tulk v Moxhay):* once the obligation in relation to a thing has been reconceptualized as a right in the thing, it becomes immaterial whether or not the original obligor can perform; everyone is bound. By contrast, this is very material where the obligation remains such. There is no point enjoining a transferee from preventing the transferor from fulfilling his obligations to the claimant, if it is clear that the transferor will not perform them.[84] In particular, once the obligation has been discharged, whether by breach or otherwise, the transferee cannot be liable for interfering with it.

Finally, we can observe that there remains an unstable body of law which may be in between *Tulk v Moxhay* and *De Mattos v Gibson:* the *Quistclose* trust.[85] Here we have a promise in relation to particular property transferred to the promisor. If that purpose fails, the property is held by the promisor on trust for the transferor.[86] There is a great deal of controversy about how to analyse the

[83] *Port Line Ltd v Ben Line Steamers Ltd* [1958] 2 QB 146, [1958] 2 WLR 551 (QBD); *Swiss Bank Corp v Lloyds Bank Ltd* (n 79 above) (Browne-Wilkinson J); Tettenborn (n 77 above) 74–75, noting a possible exception; Worthington (n 77 above) argues for a wider doctrine.

[84] Gardner discusses this as a principle that there will be no order against the transferee if there is no longer any prospect of performance: Gardner (n 70 above) 282–288.

[85] *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567. It is generally a sign of analytical immaturity when a body of law is named for a case. If this be so, all three of the bodies of law addressed in this section are not yet fully assimilated to established legal categories.

[86] This trust seems best understood as a resulting trust: R Chambers *Resulting Trusts* (Clarendon Press Oxford 1997) 83–85.

position after the transfer but before the purpose has failed. On one view it is a trust for the transferor;[87] on another, a kind of purpose trust.[88] Others doubt the soundness of the doctrine in general.[89] According to another view, there is no trust at all, but only a kind of innominate equitable proprietary interest held by the transferor.[90] If this were right, the effect would be similar to that seen in *Tulk v Moxhay*. Indeed, just as in that context, on this view the kind of promise which is in play in the *Quistclose* trust is a negative one.[91]

## 4 Proprietary Claims to Traceable Proceeds

If a trustee sells trust property, he receives some other property in exchange. If he is acting within the terms of the trust, the alienated property is no longer held in trust, but the new property is.[92] If the trustee's sale was in breach of trust, the position is slightly different; the beneficiary is not bound by the sale, and can (subject to defences) maintain that the sold property remains trust property in whosever hands it may be found. Alternatively, he can elect to say that the proceeds are instead held by the trustee in trust. This election to take the proceeds can be understood to operate through the process by which the trustee is required to account for his stewardship of the trust property. Since the sale was in breach of trust, the beneficiary need not accept it in the account. On the other hand, he may elect to do so, even though the trustee was not intending to act on behalf of the trust. Upon this election, the trustee is obliged to hold the proceeds on trust. But instantly, the obligation to hold specific property on trust is executed, and the property is so held.

This second step, executing the obligation, is not even noticed by common lawyers, but to civilians it is surprising indeed. This lies at the heart of the frequent observation that while common law systems are very generous with proprietary rights in traceable proceeds of misappropriated property, civilian systems do not recognize them except where there is specific authority. The difference is one of technique, in particular the technique of equity that if a person is obliged to transfer (or hold in trust) specific property, he automatically does

[87] P Millett "The Quistclose Trust: Who Can Enforce It?" (1985) 101 LQR 269.

[88] *Re Northern Developments (Holdings) Ltd* (ChD 6 October 1978); *Twinsectra Ltd v Yardley* [1999] Lloyd's Rep Bank 438 (CA); L Ho and P StJ Smart "Re-Interpreting the Quistclose Trust: A Critique of Chambers' Analysis" (2001) 21 OJLS 267, 285.

[89] W Swadling "A New Role for Resulting Trusts?" (1996) 16 LS 110, 120–124.

[90] Chambers (n 86 above) ch 3; L Ho and P StJ Smart "Re-Interpreting the Quistclose Trust: A Critique of Chambers' Analysis" (2001) 21 OJLS 267, 283: "Chambers' analysis requires that the courts recognize a previously undiscovered equitable right or interest." Of course if Chambers' analysis is correct, the right or interest was discovered when this kind of trust was recognized in the 19th century.

[91] Chambers (n 86 above) 74–75; criticised in Ho and Smart (n 90 above) 278–280. Where the promise is positive in nature, of course, Chambers could contemplate a "normal" trust in which the transferor/promisee was the beneficiary.

[92] This is discussed in David Fox's Chapter in this volume.

hold it on trust.[93] Civilian systems generally distinguish "personal subrogation," by which a person takes over rights held by another person, from "real subrogation," in which a thing stands in the place of another for some legal purpose. It is common, when explaining proprietary claims based on tracing to a civilian, to say that this is a generalized form of real subrogation. In a historical perspective, this is misleading, because the root of the equitable technique is not the beneficiary's rights in the thing, but the obligation owed by the trustee to the beneficiary. The "real" effect, which of course is crucial in the event of the trustee's insolvency, arises because the obligation is executed by operation of law. Just as in express trusts, this marks a conceptual shift. If the beneficiary's rights to the traceable proceeds were only in the nature of an obligation owed by the trustee, then third parties could only be made liable for wrongful interference with that obligation. Once the beneficiary's rights are proprietary rights in the traceable proceeds, third parties can be liable without wrongdoing, which generates the possibility of priority in insolvency. Although the logic of the use did not dictate that it should extend to traceable proceeds, the judges could not resist the application to such proceeds of the same technique which had given cestui que use proprietary rights in the original property.[94]

## 5 Bribes

The shift between models has apparently occurred in another context. A fiduciary takes a bribe; clearly he is accountable to the principal.[95] If this is understood as a relationship of obligation, still it is not limited to the amount received, but can, via the idea of accountability, extend to gains made with the bribe. Similarly, third parties can be affected, in this case by the wrong of dishonest involvement in a breach of fiduciary obligation.[96] But to bind the (other)

[93] This is not to suggest that this reasoning *justifies* this proprietary generosity. It merely identifies the equitable technique which gave rise to it. On justification, see L Smith *The Law of Tracing* (Clarendon Press Oxford 1997) 303–320.

[94] The earliest case of which I am aware is *Bale v Marchall* (1457) 10 SS 143. This is referred to by Lord Nottingham in his *Prolegomena of Chancery and Equity* in DEC Yale (ed) *Lord Nottingham's Two Treatises* (Cambridge University Press Cambridge 1965) ch XVI §4, citing only the date as 34 Hen 6 (1455–56). I am greatly indebted to Dr Neil Jones of Magdalene College, Cambridge, who was able to identify the Selden Society reproduction of the plaintiffs' bill, the answer, the replication, and the rejoinder, and the indorsement (dated 15 November 1457). There is some irony in this, that as we discuss the *rapprochement* of claims based on tracing "at law" and "in equity" (see *Foskett v McKeown* [2000] 2 WLR 1299 (HL)), this 15th century case was decided by the Chancellor in full consultation with the judges of the common law.

[95] *Lister v Stubbs* (1890) 45 ChD 1 (CA).

[96] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC Brunei). It remains true that accessory liability is not entirely coherent: L Smith "Constructive Fiduciaries?" in P Birks *Privacy and Loyalty* (Clarendon Press Oxford 1997) 249, 258–267. Across equity and the law, there are different mental standards (such as dishonesty and knowledge) and different levels of interference (such as inducing and assisting). The House of Lords recently refused to recognize a tort of knowingly assisting in the tort of deceit: *Credit Lyonnais Bank Nederland NV v ECGD* [2000] 1 AC 486, [1999] 2 WLR 540. See the Chapter by Charles Mitchell in this volume.

creditors of the bribee, and innocent but donative recipients, the obligation to account must be characterized as a proprietary right in the substance of the bribe. This step was taken in *A G Hong Kong v Reid*.[97] By analogy to the case of a specifically enforceable promise to transfer specific property, it was held that the bribe was held in trust at the moment it was received.[98] The decision is controversial. We can ask how useful the analogy to specifically enforceable contracts really is. As we saw when discussing those, the effect of a specifically enforceable contract to transfer Blackacre, *tout court,* is not to transfer the full beneficial interest in Blackacre to the promisee, but rather to transfer a kind of security interest. The full beneficial interest can pass without conveyance of the legal estate, but only when the purchase price is paid in full. So the question is, perhaps, not whether the faithless fiduciary was obliged in a specifically enforceable way to transfer the bribe at the moment it was received, but rather whether the victim beneficiary stands functionally in the same position as a purchaser who has paid the full price? As far as third party creditors are concerned, the answer to that second question must be no; the purchaser who has paid the full price has got his bargain, but at least he has paid for it, to the benefit of those creditors.[99]

## 6 Over-indemnification

If an insured is indemnified by her insurer, in respect of a loss for which someone else is primarily liable, and then the insured recovers from the person who is primarily liable, then the insured has been over-indemnified. She must account to her insurer for any recovery in excess of the loss she suffered.[100] Once

[97] [1994] 1 AC 324, [1993] 3 WLR 1143 (PC HK), approving Sir Peter Millett "Bribes and Secret Commissions" [1993] RLR 7.

[98] In Lord Templeman's speech, the crucial step is provided by the same maxim ("equity treats that as done which ought to be done") which justifies the shift for specifically enforceable promises to transfer. See also Sir Peter Millett (n 97 above) 29: "There is no sensible distinction between a claim to the beneficial ownership of property in the hands of the defendant which it was his contractual obligation to transfer to the plaintiff, and a claim to the beneficial ownership of property in his hands which it was his fiduciary obligation to obtain (if he obtained it at all) for the plaintiff." See S Gardner "Two Maxims of Equity" (1995) 54 CLJ 60, 60–63.

[99] The position of the creditors looms large in discussions of the correctness of *Reid,* but not always in a useful way. Anti-*Reid* says the result unjustifiably promotes the plaintiff above the general creditors (which begs the question of whether the plaintiff needs promoting); Pro-*Reid* (including Lord Templeman himself, and also Sir Peter Millett (n 97 above) says the creditors cannot expect to have that which never belonged to their debtor (which begs the question whether it did: Gardner (n 98 above)). On the other hand, it seems clear that no amount of analysis of the rights and wrongs as between fiduciary and plaintiff beneficiary can ever generate an answer as to whether a proprietary right is in order, since by definition, it will have effects outside that relationship.

[100] C Mitchell *The Law of Subrogation* (Clarendon Press Oxford 1994) 82–86. As Mitchell points out (68), this duty to account is not actually a kind of subrogation, although in common with subrogation it supports the integrity of the principle of indemnification. That principle holds that since the insurer and the insured have agreed that the insurer shall indemnify the insured, it follows that any situation in which the insurer has over-indemnified the insured is not justified by the agreement and constitutes an unjust enrichment of the insured.

again, following a familiar theme, the courts have seen an obligation in respect of particular property, and turned it into a proprietary right in that property. In *Lord Napier and Ettrick v Hunter,*[101] it was held that in such a case the insurer has an equitable lien on the money recovered from the person primarily liable. The theme shows a variation here, in that the proprietary right generated was a lien (a security interest) and not a trust (a beneficial interest). This actually fits with the underlying logic; the obligation was not to transfer the whole sum (as in the case of a bribe), but was to transfer only so much money as to ensure that there was no over-indemnification. Since the obligation related to a money amount, rather than to the whole of some *res,* a trust would be inappropriate.[102] Of course it is possible to argue here, just as in the case of a bribe, that there is no warrant for any proprietary effect to be given to the obligation.[103] And even if such effect is granted, care should be taken as to what is its subject matter.[104]

## 7 *Mareva* Injunctions

We can consider a final case, where an obligation in relation to a thing has clearly not been turned into a right in the thing: the *Mareva* injunction.[105] The defendant is enjoined from dealing with some assets. The order operates only *in personam;* it cannot be understood as giving the claimant a proprietary right in the assets. The injunction being interlocutory, the claimant has not even established any rights yet; and in the ordinary case, even if the claimant wins at trial, he will not establish any proprietary right in the assets.[106] But when the claimant gets the injunction, which is a personal obligation binding only the defendant, what does he do? He immediately rushes around to the defendant's bank to wave it at someone. Then the bank is bound by it. And so the courts have rightly said that the interests of the banks should be considered in wording the order.[107] But they are still bound once they have notice. The problem goes further: the claimant may get a worldwide injunction. By parity of reasoning, he rushes

[101] [1993] AC 713 (HL).
[102] L Smith *The Law of Tracing* (Clarendon Press Oxford 1997) 364–365. Other cases have been less careful, using the language of trust: eg, *National Fire Insurance Co v McLaren* (1886) 12 OR 682 (Ch); followed in *Mutual Insurance Co v Tucker* (1993) 119 NSR (2d) 417, 314 APR 417 (CA).
[103] Mitchell (n 100 above) 83–84.
[104] Simplifying the facts of *Colonial Furniture Co (Ottawa) Ltd v Saul Tanner Realty Ltd* (2001) 196 DLR (4th) 1 (Ont CA), the issue was whether the third party who was liable to the insured could set off a debt which the insured owed to it. The court held that it could not; because of the insurer's interest in the debt owed by the third party to the insured, that debt was not "in the same right" as the debt which the insured owed to the third party, and this precluded set off. It is arguable that the reasoning proceeded in the wrong direction; the subject matter of the trust or lien is the recovery from the third party, but the extent of that recovery should be determined independently of the insurer's claim to that recovery.
[105] Still so called in Canada, where we also continue to have plaintiffs.
[106] If the claimant is trying to establish such a right, the injunction is easier to get, and is not a *Mareva* injunction at all. See *Polly Peck International Ltd v Nadir (No 2)* [1992] 4 All ER 769 (CA).
[107] *Z Ltd v A-Z and AA-LL* [1982] QB 558, [1982] 2 WLR 288 (CA).

around to the defendant's bank in Ulan Bator to wave the order at someone. Here even the long arm of the Chancellor hesitates. Knowing involvement in a breach of the injunction by a banker in London would be contempt of court; for a number of reasons, we might not want to say the same thing of the banker in Ulan Bator. But see what must be done to prevent it: the order must be worded specifically to exclude from its operation those who are out of the jurisdiction.[108]

This shows the reach of the second model of third party liability, that is "wrongful interference in the absence of transfer." It is wrong to be involved in the breach of an injunction, even if you are not a party to the litigation. We are adamant that the injunction is *in personam,* but if we are not careful as to how we word it, anyone in the world can theoretically end up in prison for being involved in a breach of it. *In personam* indeed, we might say. And yet, it really is: the obligation imposed by the order is imposed only on the defendant. It is just like inducing breach of contract: only the party to the contract is bound to perform. But everyone else is potentially liable for wrongfully inducing a breach. There is a proprietary right which arises alongside the personal one, not as a logical necessity but as a matter of legal choice as to what counts as a wrong.

The procedural foundations of the *Mareva* injunction serve always to remind us that however wide its reach may be, it must not rise to the level of a proprietary right in the assets enjoined. This prevents us from taking the fateful step that was long ago taken for uses and trusts: making the obligation binding on non-wrongdoers who find themselves in possession of the asset to which the obligation relates. In fact, in the *Mareva* context, there is almost always another barrier to this step: the obligation does not generally relate to a specific asset at all, but rather describes the defendant's assets generally, possibly within the jurisdiction, and possibly only up to some amount sufficient to answer to the claimant's demand should it be established. In other contexts we have already examined, neither of these checks applies.

## D CONCLUSION

Everybody knows that the story of the trust is the story of how an obligation was turned into a right of property. This Chapter points out that there is already a right of property alongside every obligation, *if and to the extent* that there is a general protection against wrongful interference with that obligation. Viewed in this light, the significance of the birth of the use was not so much the creation of a proprietary right; that already existed, so far as third parties were not allowed to interfere wrongfully with the obligations of feoffee to uses. The crucial step was the shift from this abstract proprietary right to a proprietary right in the land. The practical effects of this were many. It was no longer necessary

[108] *Derby & Co Ltd v Weldon (Nos 3 & 4)* [1990] Ch 65, [1989] 2 WLR 412, [1989] 1 All ER 1002, (CA).

for cestui que use to show wrongful interference; the deck was stacked in his favour, and it was for the transferee to show, as a purchaser of the legal estate for value without notice, he took his estate free of the interest of cestui que trust. The land was not available to the creditors or the heir-at-law of the feoffee to uses.

The proprietary right to be free from wrongful interference with obligations owed to one is something we see in many contexts. Ordinary contract rights, injunctions, fiduciary obligations without trust property: in every case, an indefinite class of defendants is potentially liable for wrongful involvement in a breach.[109] But the right to performance is truly personal; the proprietary right is not a right to performance, only a right to be free of wrongful interference.

Whenever the personal obligation relates to some particular subject matter—when it is a *jus in personam ad rem*—it becomes possible to take the step which was taken so long ago in relation to uses. That is, to reconceptualize (a) the proprietary right to be free from wrongful interference with one's personal rights relating to a particular thing as (b) a proprietary right in that thing. This step we have taken, in relation to (i) specifically enforceable obligations to convey a particular thing; (ii) obligations to convey a particular thing for which value has been given; (iii) negative covenants relating to estates in land, for the benefit of adjacent land; (iv) obligations to hold on trust the proceeds of unauthorized dispositions of trust property; (v) obligations to account for recoveries which over-indemnify; and (with some controversy) (vi) obligations to account for bribes. We have flirted with it in relation to contractual obligations which concern a particular movable thing, but in the end we have drawn back; except, at least on one view, where the promise is a negative one, which generates a *Quistclose* trust.

But if the argument in this Chapter is correct, the proprietary right in the thing is born by denaturing the wrong of wrongful interference with the obligation to perform.[110] That is, starting from a case where (as is still the law for ordinary contracts) there is liability for wrongful interference, we have simply said that everyone, even if not properly called a wrongdoer, must not interfere,

[109] We also protect the personal right to performance through rules on voidable preferences and conveyances. These too were originally understood as a kind of wrongful interference, although to a greater or lesser degree, modern legal systems have denatured the wrongdoing required of either or both of the debtor and the transferee in order for the transfer to be reversible. Interestingly, in Lord Nottingham's day this was a proper subject for a constructive trust: *Prolegomena of Chancery and Equity* in DEC Yale (ed) *Lord Nottingham's Two Treatises* (Cambridge University Press Cambridge 1965) ch XIII §1, citing *Twyne's Case* (1601) 3 Co Rep 80b, 76 ER 809 (Star Chamber).

[110] In a similar way, you could preserve proprietary rights in movable things, even in the absence of any direct vindication of ownership, by denaturing the wrong of interference with goods into a wrong of strict liability: n 24 above and text. The early common law allowed the protection of rights in movable things otherwise than by the law of wrongs, but as it evolved the law of wrongs became the only practicable recourse: JH Baker *An Introduction to English Legal History* (3rd edn Butterworths London 1990) 439–452. If the only claims in respect of movable things were for wrongful interference, *and* those claims of wrongdoing depended on actual fault, proprietary rights in movable things would not be very well protected.

if the subject matter of the obligation should happen to fall into their hands.[111] To preserve the link to wrongful interference, we might say that the heir-at-law's or the donee's conscience is affected, although it is not clear what this adds to the analysis.[112] But it is not the right to performance which has been altered, only the right to be free from interference with the obligation to perform. The right to performance, I would argue, remains entirely personal.

When property is transferred in breach of trust, we may well say that the transferee is "bound by the trust" or is a constructive trustee. My conclusion is that what we mean, or should mean, is only this: he is caught by the beneficiary's right to be free of interference with the trust. This will impose an obligation on him, just as in any case in which one comes into possession of something which belongs to another.[113] The content of the obligation depends on the nature of the trust. If it is a bare trust, then the transferee is bound to hold the property to the order of the beneficiary; this harks back to the days of uses, and in this case the obligation on the transferee is much the same as the obligation which was owed by the original trustee.[114] But if the original trust was not a bare trust, it may well be that under the terms of the trust the beneficiary has no right to be in possession or control of the trust property. In this case, the obligation on the transferee will be to hold the property to the order of the trustees; likely new trustees, rather than those who transferred in breach. So properly understood, the constructive trust in this case is for the benefit of the express trustees, who hold their rights on the trusts of the express trust.[115]

There is no way to understand the transferee as "bound by the trust" in the sense of being bound to perform in just the way that the original trustee was.[116]

[111] Not everyone, of course, because of the general doctrine of bona fide purchase of a legal interest for value without notice.

[112] P Birks "Equity, Conscience and Unjust Enrichment" (1999) 23 Melb ULR 1; DR Klinck "The Unexamined 'Conscience' of Contemporary Canadian Equity" (2001) 46 McGill LJ 571.

[113] Above n 11 and text.

[114] A bare express trustee, though, will be a fiduciary; I agree with those who say there is no warrant for seeing the transferee, who is a constructive trustee, as owing fiduciary obligations: *Lonhro plc v Fayed (No 2)* [1992] 1 WLR 1, 12 (ChD); American Law Institute *Restatement of the Law of Restitution, Quasi-Contracts and Constructive Trusts* (St Paul Minn ALI 1937) §160 comment (a); L Smith "Constructive Fiduciaries?" in P Birks *Privacy and Loyalty* (Clarendon Press Oxford 1997) 249, 262–267; Sir Peter Millett "Restitution and Constructive Trusts" in W Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Oxford 1998) 199, 205; and, on resulting trusts, see J Hackney *Understanding Equity and Trusts* (Fontana London 1987) 167–168; R Chambers *Resulting Trusts* (Clarendon Press Oxford 1997) ch 9.

[115] Even in the case of the bare trust we could understand the situation this way; it is just that the original bare trustee can drop out of the analysis. Indeed this may lead us to wonder whether the best analysis is that the transferee holds the property on a resulting trust for the original trustees (or their successors): Chambers, above n 114 esp ch 4. Simpson argues that the analogy of the resulting use was the basis for holding that a transferee from feoffee to uses, who did not give value, was bound by the use: AWB Simpson *A History of the Land Law* (2nd edn Clarendon Press Oxford 1986) 180–181. The transferee held on resulting use for the original feoffee to uses; because the use was like a bare trust, the original feoffee to uses dropped out, leaving the transferee holding to the use of cestui que use; but it was not called a resulting use because the transferor was not the ultimate beneficiary.

[116] This is made clearest by *Space Investments Ltd v CIBC Trust Co (Bahamas) Ltd* [1986] 1 WLR 1072 (PC Bahamas): the obligation on the part of the trustee to perform was limited to the payment

Duties of investment and insurance, and indeed fiduciary duties, have no place in this picture.[117] Still less would we want the transferee to be vested with, and correspondingly duty-bound to turn his mind to, the fiduciary powers which the original trustee may have had. In this way, the principle that no one can be made a trustee without his consent squares rather better with all of the law of resulting and constructive trusts. Of course, if the transferee really is a wrongdoer, it may well be appropriate to impose on him obligations in addition to those just mentioned. The discussion above notices only those minimal obligations which are the obverse of the beneficiary's proprietary right to be free from interference with the performance of the trust; that right is exigible, even against an innocent transferee. But if the transferee has committed the wrong of knowingly receiving trust property, or dishonestly assisting in a breach of fiduciary obligation, his obligations will be more extensive.

In this, as in other contexts, it seems that the phrase "constructive trust" is a smokescreen between the legal analyst and the law. It is notorious that the phrase can mean many things. The roots of the trust, like the roots of the use, lie in obligations, but both long ago engendered proprietary rights. And yet "trust," especially in "constructive trust," continues to straddle obligations and proprietary rights. We may refer to trust when we are concerned only with obligations, particularly if the obligation is owed to a third party.[118] At the other extreme, some, perhaps most, understand the beneficial proprietary interest of the beneficiary to be the defining feature of the trust.[119] There is an intermediate position, which reserves the word "trust" for a relationship which partakes of both.[120] So if we hardly know what "trust" means, it is no surprise that

of a debt; it did not have a subject matter. Because of this, the liquidator could not be "bound by the trust" through coming into possession of some subject matter; nor could he be bound in the sense that he would have been liable for wrongfully inducing a breach, since he did nothing wrong; hence the only way the liquidator could be "bound by the trust" would have been through being bound to perform, which he was not.

117 Above n 114.

118 Ames suggested that the early enforcement of uses by the Chancellor was by way of following the law, which at that time allowed a third party to enforce of a promise if it was made for his benefit, in relation to a bailment or transfer of money: JB Ames "The Origin of Uses" in *Lectures on Legal History and Miscellaneous Legal Essays* (Harvard University Press Cambridge Mass 1913) 233, 239. Similarly, in the earliest examples of a pleading of assumpsit in the form "money had and received to the use of the plaintiff", the phrase "to the use of the plaintiff" meant "subject to a promise, given to another, for the plaintiff's benefit": JH Baker "The History of Quasi Contract in English Law" in W Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Oxford 1998) 37, 48–49 (". . . it was, in effect, a trust.")

119 *Hardoon v Belilios* [1901] AC 118, 123 (PC, HK); *Guerin v Canada* [1984] 2 SCR 335, 13 DLR (4th) 321, 361; Sir Peter Millett "Restitution and Constructive Trusts" in W Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Oxford 1998) 199, 204.

120 See the speech of Lord Browne-Wilkinson in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, [1996] 2 WLR 802, who takes the view that although the beneficial interest in property be separated from legal ownership, the relationship is not properly called a trust unless the trustee is sufficiently bound by personal obligations to the beneficiary. One point in favour of this view is that it fits the standard usage which would deny that the relationship between mortgagor and mortgagee is a trust. See however DWM Waters *The Constructive Trust* (Athlone Press London 1964) ch III 144, noting that it was commonly so called up to the end of the 19th century. Waters'

"constructive trust" is used in different ways. A constructive trust which is nothing but obligations is still seen when a defendant is "liable to account as a constructive trustee"; this is a personal liability for interfering with the performance of a trustee's obligations.[121] Similarly, the use of the phrase by Lord Shaw in *Lord Strathcona SS Co v Dominion Coal Co*[122] seemed only to mean that the third party was bound not to interfere with the obligations owed to the claimant by someone else.

But I have argued that the constructive trust which applies when property is transferred in breach of trust is nothing but a right to be free from interference with the performance of the trust. In that sense, Lord Shaw's slip is perhaps understandable. Although there was no constructive trust on the facts before him, the constructive trust which arises when property is transferred in breach of trust was built on the same conceptual model which Lord Shaw was applying: a protection against wrongful interference with obligations.[123] Through this constructive trust, equity has taken the proprietary right to be free from wrongful interference with the performance of a *jus in personam ad rem,* and it has turned it into a proprietary right in the *res*. That was a step of momentous significance. But the proprietary right in the *res* remains a proprietary right to be free of interference with the performance of the trust. So understood, this right can be seen as having been created by the same event which created the original trust, and as surviving intact through the transfer to the transferee. At the same time, it does not follow that the transferee will succeed to the office of the original trustee. Whether all of that can usefully be captured by the phrase "constructive trust" is another question. Penner valiantly attempts to salvage the old language by saying that the transferee is "constructive trustee of an express trust interest";[124] this is the best effort on the table; but the time may come when we can no longer live with "constructive trust."*

argument has a lot in common with the position of Lord Browne-Wilkinson; in chs II and III he argues that it is confusing to refer to the relationships between vendor and purchaser, and mortgagor and mortgagee, in terms of constructive trust, since those relationships have so little in common with express trusts.

121 The old terminology is frequently criticized: *Paragon Finance plc v D B Thakerar & Co (a firm)* [1999] 1 All ER 400 (CA); Sir Peter Millett "Restitution and Constructive Trusts" in W Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Oxford 1998) 199, 200; L Smith "Constructive Trusts and Constructive Trustees" (1999) 58 CLJ 294.

122 [1926] AC 108, 125 (PC Nova Scotia).

123 I would understand other constructive trusts to be built on different conceptual foundations.

124 JE Penner *The Law of Trusts* (2nd edn Butterworths London 2000) 120.

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# 6

# *Assistance*

CHARLES MITCHELL

## A INTRODUCTION

### 1 *Royal Brunei Airlines Sdn Bhd v Tan*

IN HIS WELL known speech for the Privy Council in *Royal Brunei Airlines Sdn Bhd v Tan*,[1] Lord Nicholls held that equitable "accessory liability . . . attaches to a person who dishonestly procures or assists in a breach of trust or fiduciary obligation,"[2] and he realigned liability for dishonest procurement with liability for dishonest assistance, by holding that neither form of liability depends upon a finding that the wrongdoing trustee or fiduciary has been dishonest.[3] In so holding, Lord Nicholls reversed the decision of the Brunei Court of Appeal, which had itself been founded on the decisions of the English Court of Appeal in *Barnes v Addy*[4] and *Belmont Finance Corp v Williams Furniture Ltd*,[5] that liability for

[1] [1995] 2 AC 378.
[2] *Royal Brunei* (n 1 above) 392. Cf *Australian Securities Commission v AS Nominees Ltd* (1995) 62 FCR 504, 523 (Finn J), referring to knowing assistance as "a fault-based form of accessorial liability".
[3] *Royal Brunei* (n 1 above) 385, holding that it "would make no sense" to absolve a dishonest assistant from liability on the ground that the trustee or fiduciary has committed a breach of duty in good faith. Liability for dishonestly inducing an innocent breach of trust has been well established in English law since the mid-19th century: *Fyler v Fyler* (1841) 3 Beav 550, 49 ER 216; *A-G v Corporation of Leicester* (1844) 7 Beav 176, 49 ER 1031; *Alleyne v Darcy* (1854) 4 Ir Ch App 199; *Eaves v Hickson* (1861) 30 Beav 136, 54 ER 840; *Re Midgely* [1893] 3 Ch 282. In the first two of these, Lord Langdale MR "did not distinguish between inducement and assistance, nor did he regard the moral quality of the breach induced or assisted as relevant . . . The [subsequent] restriction of liability [for assistance] to those instances in which the breach assisted was fraudulent seems therefore to have leapt forth fully formed from the brow of Lord Selborne" in *Barnes v Addy* (1874) LR 9 Ch App 244: C Harpum "The Basis of Equitable Liability" in P Birks (ed) *The Frontiers of Liability* vol 1 (OUP Oxford 1994) 9, 11–12. The relationship between liability for assistance and liability for inducement is considered further in part B, section (2) below.
[4] (1874) 9 Ch App 244, 251–2 (Lord Selborne LC, sitting in the Court of Appeal in Chancery).
[5] [1979] Ch 250, 267 (Buckley LJ) and 273–4 (Goff LJ), rejecting *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, 1591 (Ungoed-Thomas J). See also *Belmont Finance Corp Ltd v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 405 (Buckley LJ) and 407 (Goff LJ). For further discussion, see part C, section 2(c) below.

assistance in a breach of trust or other fiduciary duty can arise only where the trustee or fiduciary has acted dishonestly.

It may have been unnecessary for the Privy Council to depart from the English Court of Appeal's previous decisions on this point, as their Lordships seem to have thought that the breach of trust committed by Tan's company in the *Royal Brunei* case had been dishonest on the facts. This appears from Lord Nicholls' statement that:[6]

> The [Brunei] Court of Appeal held that it was not established that [Tan's company] BLT was guilty of fraud or dishonesty in relation to the amounts it held for the airline. Their Lordships understand that by this the Court of Appeal meant that it was not established that the defendant [Tan, whose mind was "identified" with BLT's mind[7]] intended to defraud the airline. The defendant hoped, maybe expected, to be able to pay the airline, but the money was lost in the ordinary course of a poorly-run business with heavy overhead expenses. These facts are beside the point. The defendant had no right to employ the money in the business at all.

But even if their Lordships did have to decide this point of law as the point remitted to them for decision, it was clearly the only point of law which they had to decide. Tan had expressly conceded that a breach of trust had been committed, that he had assisted in this breach of trust, and that he had done so with actual knowledge of the breach. It was therefore uncontroversial that he had committed the "*actus reus*" of assistance, and had possessed the requisite state of mind for liability. Lord Nicholls could therefore have left matters at that. But he did not. Instead, he chose to revisit the law governing the mental element of liability for assisting in a breach of trust, and to recast the law on this question in terms which downplayed the significance of the defendant's knowledge.

Previously, in *Baden, Delvaux v Société Générale pour Favoriser le Développement du Commerce et de l'Industrie en France SA*,[8] Peter Gibson J had held that a defendant might be liable for assistance even if his behaviour fell short of dishonesty,[9] and he had accepted that any of five types of knowledge would serve to render a defendant liable as an assistant in a breach of trust: (i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which would put an honest and reasonable man on inquiry.[10] He had also held that types (ii)–(v) could all be distinguished from type (i), as constituting various types of "imputed" or "con-

[6] *Royal Brunei* (n 1 above) 393 (Lord Nicholls).
[7] For further discussion of the corporate identification doctrine, see part C, sections 3(c) and 4(f) below.
[8] [1993] 1 WLR 509.
[9] *Baden, Delvaux v Société Générale* (n 8 above) 577.
[10] *Baden, Delvaux v Société Générale* (n 8 above) 575–587.

structive knowledge."[11] The *Baden, Delvaux* classification of knowledge had then formed the starting point for discussion in a series of English cases on liability for assistance. The points had been made in these cases, that categories (ii) and (iii) should more properly be understood as types of actual, rather than constructive knowledge;[12] that constructive knowledge is not the same thing as constructive notice;[13] that in commercial transactions, men of business do not normally make inquiries unless the facts are such as to raise suspicion, suggesting that constructive notice, as that term is generally understood in relation to dealings with land, has only a limited role to play in the context of commercial transactions;[14] that categories (i), (ii), and (iii) certainly suffice for liability as an assistant;[15] and that categories (iv) and (v) are phrased in a way that might take in dishonest as well as negligent states of mind.[16] A consensus had also emerged that, contrary to Peter Gibson J's finding in *Baden, Delvaux*, a defendant must have been dishonest to incur liability.[17]

The view that dishonesty is a pre-requisite for liability had not been put beyond doubt, however: a line of cases pre-dating *Baden, Delvaux*, holding that

[11] *Baden, Delvaux v Société Générale* (n 8 above) 576.

[12] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 293 (Millett J); *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1103 (Knox J).

[13] On the distinction, see esp *Re Montagu's ST* [1987] Ch 264, 277–9 (Megarry V-C).

[14] *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1112 (Knox J); *Eagle Trust plc v SBC Securities Ltd* [1993] 1 WLR 484, 492–3 (Vinelott J); *El Ajou v Dollar Land Holdings plc* [1993] BCLC 735, 758 (Millett J). But cf *Westpac Banking Corp v Savin* [1985] 2 NZLR 41, 53 (Richardson J): "Clearly courts would not readily import a duty to inquire in a case of commercial transactions where they must be conscious of the seriously inhibiting effects of a wide application of the doctrine. Nevertheless there must be cases where there is no justification on the known facts for allowing a commercial man who has received funds paid to him in breach of trust to plead the shelter of the exigencies of commercial life."

[15] *Re Montagu's ST* [1987] Ch 264, 272 (Megarry V-C); *Lipkin Gorman v Karpnale Ltd* [1987] 1 WLR 987, 1005–6 (Alliott J), aff'd [1989] 1 WLR 1340, 1355 (May LJ).

[16] A point made in *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 293 (Millett J), warning against a "too ready assumption that categories (iv) and (v) are necessarily cases of constructive notice only." See too *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1112 (Knox J). And cf *Agip (Africa) Ltd v Jackson* [1991] Ch 547, 567 and 569 (Fox LJ) accepting that any of the five *Baden, Delvaux* scales of knowledge would suffice for liability, and later stating that "the question is whether [the defendant] has acted honestly."

[17] *Re Montagu's ST* [1987] Ch 264, 285 (Megarry V-C); *Agip (Africa) Ltd v Jackson* [1990] 1 Ch 265, 292–3 (Millett J); [1991] Ch 547, 569 (Fox LJ); *Eagle Trust plc v SBC Securities Ltd* [1993] 1 WLR 484, 495 (Vinelott J); *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340, 1354–5 (May LJ); *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1101 (Knox J); *Polly Peck International v Nadir (No 2)* [1993] BCLC 187, 203–4 (Scott LJ); *Bank Tejerat v Hong Kong and Shanghai Banking Corp (CI) Ltd* [1995] 1 Lloyd's Rep 239, 248 (Tuckey J). See too *Carl Zeiss Stiftung v Herbert Smith & Co (No 2)* [1969] 2 Ch 276, 298–9 (Sachs LJ) and 301 (Edmund-Davies LJ); *Competitive Insurance Co Ltd v Davies Investments Ltd* [1975] 1 WLR 1240, 1250 (Goff J); *Belmont Finance Corp v Williams Furniture Ltd* [1979] Ch 250, 267–8 (Buckley LJ) and 275 (Goff LJ). And cf *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 376 (Barwick CJ), 398 (Gibbs J), and 408–412 (Stephen J); *Westpac Banking Corp v Savin* [1985] 2 NZLR 41,70 (Sir Clifford Richmond); *Marr v Arabco Traders Ltd* (1987) 1 NZBLC 102,732, 102,762 (Tompkins J); *Equiticorp Industries Group Ltd v Hawkins* [1991] 3 NZLR 700, 728 (Wylie J); *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218, 228 (Blanchard J); *Springfield Acres Ltd (in liq) v Abacus (Hong Kong) Ltd* [1994] 3 NZLR 502, 510 (Henry J).

a defendant can be liable if he has honestly but negligently failed to investigate the circumstances of an impugned transaction, had never been overruled.[18] The body of law founded on the *Baden, Delvaux* classification also suffered from the more general problem that it had become over-theorized: in Lord Nicholls' view, the courts had been led into "tortuous convolutions" in their efforts to investigate the "sort" of knowledge possessed by defendants, "when the truth is that 'knowingly' is inapt as a criterion when applied to the gradually darkening spectrum where the differences are of degree and not kind."[19]

Lord Nicholls was therefore determined to start afresh. He held that knowledge is best avoided as a defining ingredient of liability, and that the *Baden, Delvaux* scale is best forgotten.[20] He rejected the idea that unconscionability should be the touchstone for liability, unless it is made clear "what, *in this context*, unconscionable *means*."[21] He held that the test should instead be dishonesty, judged to an objective standard: would an honest person in the defendant's position have acted in the way that the defendant had acted? If not, then the defendant would be liable.

## 2 The *Royal Brunei* Case in the English and Commonwealth Courts

Since the *Royal Brunei* case, a flood of cases has swept through the English and Commonwealth courts, in which claimants have sought to fix defendants with liability for assisting in a breach of trust or fiduciary obligation. As a decision of the Privy Council, the *Royal Brunei* case is technically weaker authority in

[18] *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555; *Karak Rubber Co Ltd v Burden (No 2)* [1972] 1 WLR 602; *Rowlandson v National Westminster Bank Ltd* [1978] 1 WLR 798.

[19] *Royal Brunei* (n 1 above) 391. Cf *Agip (Africa) Ltd v Jackson* [1990] 1 Ch 265, 293 (Millett J), followed in *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1112 (Knox J), warning against "over-refinement"; *Nimmo v Westpac Banking Corp* [1993] NZLR 218, 228 (Blanchard J), describing the *Baden, Delvaux* categories as "unhelpful" and "unrememberable"; *Three Rivers DC v Governor and Company of the Bank of England (No 3)* [2000] 2 WLR 15, 62 (Hirst LJ), stating that the *Baden, Delvaux* classification is "over-elaborate," and adding for good measure that "its point (iii) in effect defines recklessness in a circular manner." See too P D Finn "The Liability of Third Parties for Knowing Receipt or Assistance" in D W M Waters (ed) *Equity, Fiduciaries, and Trusts* (Carswell Toronto 1993) 195, 196, describing the *Baden, Delvaux* scale as "technical to the point of the artificial and the arcane."

[20] *Royal Brunei* (n 1 above) 392.

[21] *Royal Brunei* (n 1 above) 392 (his emphasis), adding that "if unconscionable means no more than dishonesty, then dishonesty is the preferable label." In *Powell v Thompson* [1991] 1 NZLR 597, 610–612, Thomas J held that unconscionability including negligence would suffice. However, while the New Zealand courts subsequently accepted that unconscionability should be the test for liability, they also held that negligence was not enough to found liability: *Equiticorp Industries Group Ltd v Hawkins* [1991] 3 NZLR 700, 728 (Wylie J); *Marshall Futures Ltd v Marshall* [1992] 1 NZLR 316, 325 (Tipping J), observing that "I would prefer the herald of equity to be wearing more distinctive clothing than that suggested by the formulation which appealed to Thomas J. If conduct which is less reprehensible than that which can be described as fraudulent and dishonest but which is nevertheless properly to be described as unconscionable is to be sufficient I am not sure how one is to identify such conduct."

England than decisions such as those of the Court of Appeal in *Barnes v Addy*[22] and *Belmont Finance Corp v Williams Furniture Ltd*,[23] but still the English courts have aligned themselves with the views of the Privy Council in subsequent cases. In *Dubai Aluminium Co Ltd v Salaam*,[24] for example, Rix J preferred the *Royal Brunei* case to the *Belmont Finance* case on the question whether an "objective" or "subjective" test of dishonesty should be used to determine an assistant's liability—although as Rix J correctly observed, the Court of Appeal neither needed nor intended to decide the nature of the mental element for liability in the *Belmont Finance* case, as the issue there was merely whether the claimant had properly alleged dishonesty in its pleadings.[25] In *Grupo Torras SA v Al-Sabah (No 5)*,[26] the Court of Appeal described the *Royal Brunei* case as "the leading case" on liability for assisting in a breach of trust or fiduciary duty. Likewise, in *Bank of Scotland v A Ltd*,[27] the Court of Appeal considered that the "whole of [Lord Nicholls'] opinion . . . merits careful study," and that it contains "the most recent and clearest guidance" out of "all the authorities" on the "test of guilty knowledge" for such liability. More generally, the English courts have also come to refer to liability for assisting in a breach of trust as liability for "dishonest assistance."[28]

The language of "dishonest assistance", and the rule which it articulates, have also been adopted in the courts of Malaysia,[29] New Zealand,[30] and Singapore.[31] The Australian courts have mostly persisted with the language of "knowing assistance," but at least up to the level of the state appellate courts they too have followed the *Royal Brunei* case to hold that dishonesty is required for liability.[32] The

[22] (1874) 9 Ch App 244.
[23] [1979] Ch 250.
[24] [1999] 1 Lloyd's Rep 415, 452; this point was not taken on appeal: [2001] QB 113.
[25] See eg, [1979] Ch 250, 267–8 (Buckley LJ): "It is not strictly necessary . . . for us to decide [the degree of knowledge required for liability] on this appeal." The pleading rules governing allegations of dishonesty are considered in part C, section 4(a), below, and the nature of the test for dishonesty laid down in the *Royal Brunei* case is discussed in part C, section 4(c), below.
[26] [2001] Lloyd's Rep Bank 36, 56 (per curiam).
[27] [2001] 1 WLR 751, 761. See too *Three Rivers DC v Governor and Company of the Bank of England (No 3)* [2000] 2 WLR 15, 62 (Hirst LJ).
[28] See eg, *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734, 756 (Rimer J): "what used to be known as 'knowing assistance' . . . is now known as 'dishonest assistance'"; *Walker v Stones* [2001] QB 902, 947 (Sir Christopher Slade): "This was intended by the claimants as a plea of dishonest assistance in breaches of trust."
[29] *Industrial Concrete Products Bhd v Concrete Engineering Products Ltd* [2001] 2 MLJ 332, 363 (James Foong J).
[30] *Cigna Life Insurance New Zealand Ltd v Westpac Securities Ltd* [1996] 1 NZLR 80, 87–8 (Greig J), relying on the *Royal Brunei* case for his conclusion that "dishonesty is an essential ingredient" of liability for "knowing assistance"; *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 540 (Smellie J), referring to the "dishonest assistance claims (as the knowing assistance claims are more properly described)." In the *Equiticorp* case at 640, Smellie J also states that "*Tan* has, of course, cleared the ground here. There is no longer room for argument. Dishonesty, assessed objectively, 'is a necessary ingredient for accessory liability.'"
[31] *Banque Nationale de Paris v Hew* [2001] 1 SLR 300.
[32] First instance decisions: *Turner v TR Nominees Pty Ltd* (1995) 31 ATR 578, 592 (Santow J); *Colour Control Centre Pty Ltd v Ty* (NSW Sup Ct (Eq Div) 24 July 1995), para 60 (Santow J);

Canadian courts, in contrast, continue to use the term "knowing assistance,"[33] and at the same time they continue to follow Iacobucci J's finding in *Air Canada v M & L Travel Ltd*, that knowledge is the touchstone for liability, and that "it is unnecessary . . . to find that the [assistant] himself acted in bad faith or dishonestly."[34] However, it seems unlikely that the Canadian courts would find a defendant liable for knowing assistance who would not also be liable under Lord Nicholls' "dishonesty" test, for Iacobucci J also held in the *Air Canada* case that "the knowledge requirement for this type of liability is actual knowledge . . . recklessness or wilful blindness,"[35] a formulation which is echoed in Lord Nicholls' dictum that "acting in reckless disregard of others' rights or possible rights can be a tell-tale sign of dishonesty."[36]

*Farrow Finance Co Ltd (in liq) v Farrow Properties Pty Ltd (in liq)* (1997) 26 ACSR 544, 586 (Hansen J), followed in *Hancock Family Memorial Foundation Ltd v Porteous* (1999) 32 ACSR 124, 141 (Anderson J) (aff'd on another point [2000] WASCA 29, itself aff'd [2000] HCA 51); *Compaq Computer Australia Pty Ltd v Merry* (1998) 157 ALR 1, 21 (Finkelstein J); *Currububula Holdings Pty Ltd v DRE Downtown Real Estate Pty Ltd* [1998] NSWSC 518; *Re Tietyens Investments Pty Ltd* [1999] FCA 206, para 90 (Weinberg J); *Hungry Jack's Pty Ltd v Burger King Corp* [1999] NSWSC 1029 (Rolfe J); *Rogers v Kabriel* [1999] NSWSC 368, para 174 (Young J); *Temwood Holdings Pty Ltd v Oliver* [2000] WASC 69, paras 41–2 (Steytler J); *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corp Ltd)* [2001] NSWSC 14 (Austin J); *National Australia Bank Ltd v Rusu* [2001] NSWSC 32, para 40 (Bryson J).

In the Victoria Court of Appeal, in *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd* [1998] 3 VR 133, 156, Tadgell JA considered that "it may be that the [*Royal Brunei*] test should be applied in Australia." Subsequently, in *Burger King Corp v Hungry Jack's Pty Ltd* (NSWCA 21 June 2001), the New South Wales Court of Appeal applied it: Sheller, Beazley and Stein JJA jointly affirmed Rolfe J's discussion at first instance, cited above, and stated that because Rolfe J had been "entitled to find BKC's conduct dishonest or lacking in probity . . . [there] was . . . created 'a liability in equity to make good [the] resulting loss' which [attached] to BKC which [had] 'dishonestly [procured] or [assisted] in a breach of trust or fiduciary obligation'" (quoting from the *Royal Brunei* case, above n 1, 392 (Lord Nicholls)).

In the High Court of Australia, in *Pilmer v The Duke Group Ltd (in liq)* [2001] HCA 31, para 3, McHugh, Gummow, Hayne, and Callinan JJ observed in passing that "there was no allegation that the appellants were accountable in equity . . . on the footing that they had dishonestly assisted the directors to breach their fiduciary duties thereby attracting the application of the principles discussed in such decisions" as the *Royal Brunei* case.

[33] See eg, *Gold v Rosenberg* [1997] 3 SCR 767, 780 (Iacobucci J); *Citadel General Assurance Co v Lloyd's Bank Canada* [1997] 3 SCR 805, 819 (La Forest J); *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 248 (Huband JA).

[34] [1993] 3 SCR 787, 826, recently followed in eg, *Sorrel 1985 Limited Partnership v Sorrel Resources Ltd* [2001] 1 WWR 93, 112–3 (Picard JA).

[35] *Air Canada v M & L Travel Ltd* (n 34 above) 811, affirmed in *Citadel General Assurance Co v Lloyd's Bank Canada* [1997] 3 SCR 805, 820 (La Forest J). See too *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 248 (Huband JA).

[36] *Royal Brunei* (n 1 above) 390. Cf *Walker v Stones* [2001] QB 902, 944 (Sir Christopher Slade); *HR v JAPT* (1998/1999) 2 OFLR 252, 282–3 (Lindsay J): "There may sometimes be difficult lines to draw between a person taking risks as to what he understands to be his own position and his affecting to do so to avoid knowledge of a risk to others that he was preferring to ignore. Despite occasional difficult distinctions of fact and questions of credibility arising on the facts, the fact that a person takes a risk in relation to what is genuinely beneficially wholly his own or which is truly and reasonably seen by him as likely to affect not others but only himself will in most cases be irrelevant to accessory liability . . . *Royal Brunei* dishonesty, so far as concerned with risk, is not directed to the taking of a risk in relation to one's own position but with the taking of a risk which . . . might jeopardise the position of others."

## 3 The Purpose, Structure, and Scope of the Chapter

The aim of this chapter is to discuss how Lord Nicholls' efforts to recast the law in this area have fared in the courts, and to see what else the cases since the *Royal Brunei* case have to tell us about liability for dishonest assistance. Several excellent studies of liability for dishonest (or knowing) assistance have already been written, most notably those by Charles Harpum.[37] However, this Chapter has been undertaken in the belief that the new cases have brought some interesting new issues to the fore, and have cast new light on some familiar issues as well.

The Chapter is divided as follows. The juridical nature of liability for dishonest assistance is considered in part B. In part C, the components of a claim in dishonest assistance are examined, as are some of the defences to a claim in dishonest assistance in part D. Some brief conclusions are then drawn in part E. Nothing is said here about the remedies to which successful claimants are entitled, an important and interesting subject which could not be treated properly without further extending a Chapter that is already too long.[38] Nor is anything said about vicarious liability for dishonest assistance,[39] dishonest assistance

[37] C Harpum "The Stranger as Constructive Trustee" (1986) 102 LQR 114 and 267; P D Finn "The Liability of Third Parties for Knowing Receipt or Assistance" in D W M Waters (ed) *Equity, Fiduciaries and Trusts* (Carswell Toronto 1993) 195; C Harpum "The Basis of Equitable Liability" in P Birks (ed) *The Frontiers of Liability* vol 1 (OUP Oxford 1994) 9; S Gardner "Knowing Assistance and Knowing Receipt: Taking Stock" (1996) 112 LQR 56; A J Oakley *Constructive Trusts* (3rd edn Sweet & Maxwell London 1997) 186–222; J Mowbray et al (eds), *Lewin on Trusts* (17th edn Sweet & Maxwell London 2000) 1240–1260.

[38] Issues that one might wish to consider in this connection include: (i) how "the courts . . . have extended the equitable remedy of discovery as revitalized by [*Norwich Pharmacal Co v Customs & Excise Commissioners* [1974] AC 133] to combat the stratagems and chameleon antics of fraudsters," including dishonest assistants, as discussed in *Alberta Treasury Branches v Leahy* (Alberta QB 18 August 2000) paras 68–106 (Mason J); and see too *Sumitomo Corp v Credit Lyonnais Rouse Ltd* [2001] 2 Lloyd's Rep 517; *Irawan v WB Ltd* (Victoria Sup Ct (Comm and Eq Divs) 11 Oct 2001); (ii) how the tracing rules can be needed to show that a dishonest assistant has handled property which is traceably the proceeds of property belonging to the claimant, as in eg, *Agip (Africa) Ltd v Jackson* [1990] Ch 265, aff'd [1991] Ch 547; *Bank Tejerat v Hong Kong and Shanghai Banking Corp (CI) Ltd* [1995] 1 Lloyd's Rep 239, 247–8 (Tuckey J); but note *Foskett v McKeown* [2001] 1 AC 102, 113 (Lord Steyn) and 128–9 (Lord Millett), holding that there is a single set of tracing rules, and so effectively abrogating the requirement that a fiduciary relationship is needed to bring the "equitable" rules into play; (iii) how loss based awards against dishonest assistants can be assessed, as to which see eg, *Colour Control Centre Pty Ltd v Ty* (NSW Sup Ct (Eq Div) 24 July 1995) (hereafter *Colour Control Centre*) paras 64–71 (Santow J); *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 644–6 and 658–668 (Smellie J); *News International plc v Clinger* (ChD 17 November 1998) esp para 388 (Lindsay J); *Northland Bank v Willson* (1999) 249 AR 201, esp 238 (Wilkins J); *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643, (hereafter *Fyffes Group*) 660–668 (Toulson J), noted C Mitchell "Civil Liability for Bribery" (2001) 116 LQR 207; *Alers-Hankey v Solomon* (British Columbia Sup Ct 8 December 2000); (iv) how gain-based awards can be assessed, as to which see eg, *Timber Engineering Co Pty Ltd v Anderson* [1980] 2 NSWLR 488, 495 (Kearney J); *Colour Control Centre*, paras 72–6 (Santow J); *Fyffes Group*, 668–672 (Toulson J); (v) whether gain-based awards should be personal or proprietary, in which connection note *Nanus Asia Co Inc v Standard Chartered Bank* [1990] 1 HKLR 396.

[39] As to which, see *Mara v Browne* [1896] 1 Ch 199 and *Re Bell's Indenture* [1980] 1 WLR 1217, both followed in *Estate Realties Ltd v Wignall* [1992] 2 NZLR 615, 634–5 (Tipping J), but not cited or considered in *Agip (Africa) Ltd v Jackson* [1990] Ch 265, itself aff'd [1991] Ch 547; *Young v*

claims in the conflict of laws,[40] or contribution claims between dishonest assistants and other parties who are jointly and severally liable with them for the same loss to the same beneficiaries or principal.[41]

## B THE JURIDICAL NATURE OF LIABILITY FOR DISHONEST ASSISTANCE

This part will be divided into two sections. First, it is considered what the courts mean when they say that a dishonest assistant is liable "as a constructive trustee," and how this terminology continues to cause them trouble. Secondly, something is said about the relationship between liability for dishonest assistance, liability for inducing a breach of trust, and liability for knowingly receiving trust property.

### 1 Liability as a Constructive Trustee

It is "essential to the character of a trustee that he should have trust property actually vested in him or so far under his control that he has nothing to do but require that, perhaps by one process, perhaps by another, it should be vested in him."[42] Liability as a dishonest assistant "is not dependent upon receipt of trust property" and "arises even though no trust property has reached the hands of the accessory."[43] Taken together, these propositions tell us that although dishonest

*Murphy* [1996] 1 VR 279, 315 (J D Phillips J); *McDonic v Heatherington* (1997) 142 DLR (4th) 648; *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, 466–471 (Rix J), overruled [2001] QB 113, noted C Mitchell (2001) 16 Tru LI 164. Leave to appeal from the CA's decision in the *Dubai Aluminium* case has been granted: [2001] 1 WLR 884. More recently, in *Balfron Trustees Ltd v Peterson* (2001) 151 NLJ 1180, transcript paras 22–39, Laddie J reassessed the rules governing the imposition of vicarious liability for dishonest assistance in the light of the HL's decision in *Lister v Hesley Hall Ltd* [2001] 2 WLR 1311.

40 On jurisdiction: *Casio Computer Ltd v Sayo* The Times 6 February 2001, aff'd [2001] EWCA Civ 661; *Dexter Ltd (in admin rec'ship) v Harley* The Times 2 April 2001, both noted TM Yeo (2001) 116 LQR 560. On choice of law: *Thahir v PT Pertambangan Minyak das Gas Bumi Negara (Pertamina)* [1994] 3 SLR 257; *Arab Monetary Fund v Hashim (No 9)* (Ch D 29 July 1994); *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, 467 (Rix J), not considered on appeal: [2001] QB 113; *Grupo Torras SA v Al-Sabah (No 5)* [2001] Lloyd's Rep Bank 36, 62–6 (per curiam). For general discussion, see J Bird "Choice of Law", and R Stevens "The Choice of Law Rules of Restitutionary Obligations", both in F D Rose (ed) *Restitution and the Conflict of Laws* (Mansfield Press Oxford 1995), respectively at 94–6, and 188–91 and 215–8; G Panagopoulos, *Restitution in Private International Law* (Hart Publishing Oxford 2000) 90–1.

41 Considered in C Mitchell "Apportioning Liability for Trust Losses" in P Birks and F D Rose (eds) *Restitution and Equity, Vol I: Resulting Trusts and Equitable Compensation* (LLP Ltd London 2000) 211.

42 *Re Barney* [1892] 2 Ch 265, 273 (Kekewich J).

43 *Royal Brunei* (n 1 above) 382 (Lord Nicholls). See too *Houghton v Fayers* [2000] Lloyd's Rep Bank 145, 149 (Nourse LJ); *Montreal Trust Co of Canada v Hickman* [2001] NFCA 42, para 46 (Green JA). Also, Sir P Millett (now Lord Millett) "Tracing the Proceeds of Fraud" (1991) 107 LQR 71, 83: "The accessory is a person who either never received [property paid away in breach of trust] at all, or who received it in circumstances where his receipt was irrelevant."

assistants are often said to be personally liable to account to claimants "as constructive trustees," this expression cannot mean that a dishonest assistant's personal liability to account *derives from* the imposition of a trust for the claimant on property in the dishonest assistant's hands (albeit that in some rare cases a constructive trust is imposed on the profits derived by a dishonest assistant from his wrongdoing[44]). It can only mean that his personal liability to account *resembles* the personal liability of a trustee to account to his beneficiary.

It is true that in *Westdeutsche Landesbank Girozentrale v Islington LBC*,[45] Lord Browne-Wilkinson spoke of a "constructive trust imposed on a person who dishonestly assists in a breach of trust who may come under fiduciary duties even if he does not receive identifiable trust property," and considered that this "trust" is "an apparent exception" to the rule that "in order to establish a trust there must be trust property." But with respect to his Lordship, the better view is that the term "constructive trust" is "simply used [in the context of claims for dishonest assistance] to describe the equitable obligation to account which is imposed upon [the defendant]."[46] There is no trust imposed on property in his hands; he "is not in fact a trustee at all, even if he may be liable to account as if he were";[47] and when the courts speak of him as coming under a personal liability to account "as a constructive trustee", this is "nothing more than a formula for equitable relief."[48]

One reason why courts like to use this formula is that it enables them to preserve the orthodoxy that beneficiaries cannot sue anyone except their trustees, while simultaneously allowing beneficiaries to sue third parties such as dishonest assistants for their participation in breaches of trust.[49] The courts also like to use it because they are creatures of habit, and they believe that even if the formula adds nothing, it does no harm to let it roll off the tongue. However, while it is fair

[44] See eg, *Nanus Asia Co Inc v Standard Chartered Bank* [1990] 1 HKLR 396, 417–9 (Cruden DHCJ), holding that an insider trader who had made a profit by knowingly assisting in the breach of confidence committed by his source, the employee of a merchant bank, would hold these profits on a constructive trust for the merchant bank, and moreover, that a second bank with which the insider trader had deposited these profits should itself hold them on constructive trust for the merchant bank.

[45] [1996] AC 669, 705. See too *Giumelli v Giumelli* (1999) 196 CLR 101, 112 (Gleeson CJ, McHugh, Gummow, and Callinan JJ).

[46] *Twinsectra Ltd v Yardley* [1999] Lloyd's Rep Bank 438, 467 (Potter LJ). Further dicta to this effect can be found in: *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 292 (Millett J); *Equiticorp Finance Ltd v Bank of New Zealand* (1993) 32 NSWLR 50, 104–5 (Kirby P); *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218, 226 (Blanchard P). See too P Birks "Trusts in the Recovery of Misapplied Assets" in E McKendrick (ed) *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon Press Oxford 1992) 149, 154; Sir P Millett (now Lord Millett) "Restitution and Constructive Trusts" in W R Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Publishing Oxford 1998) 199, 200; Lord Millett "The Law of Restitution: Taking Stock" (1999) 14 Amicus Curiae 4, 6–7.

[47] *Paragon Finance plc v DB Thackerar & Co* [1999] 1 All ER 400, 409 (Millett LJ). See too *Belmont Finance Corp Ltd v Williams Furniture Ltd* [1979] Ch 250, 272 (Goff LJ): "it was neither necessary nor proper to plead that the [defendants sued for dishonest assistance] were trustees or that they had committed a breach of trust."

[48] *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, 1582 (Ungoed-Thomas J).

[49] This is discussed further, in part C, section (1)(a), below.

to say that in most of the cases discussed here,[50] the courts have not been distracted by this "ambiguous and misleading phrase,"[51] in a few of them they have been misled by the terminology. They have developed the law in terms that are premised on the mistaken view that liability as a dishonest assistant derives from the imposition of some kind of trust obligation.

Reasoning of this kind underpinned the findings by Cresswell J and David Steel J, in *Bankgesellschaft Berlin AG v Makris*[52] and *Petrotrade Inc v Smith*,[53] respectively, that liability for dishonest assistance can only be incurred where the primary breach of duty complained of has entailed the misapplication of property.[54] In *Dubai Aluminium Co Ltd v Salaam*,[55] Turner J (sitting in the Court of Appeal) held that a partner who is liable for dishonest assistance is liable as a constructive "trustee" who has misapplied trust property, with the result that the question whether his co-partners are vicariously liable for his wrongdoing is governed by section 13 rather than section 10 of the Partnership Act 1890. And in *Brinks Ltd v Abu-Saleh (No 3)*,[56] Rimer J considered that a defendant can only be liable for dishonest assistance where he has known of "the trust in question (or at least of the facts giving rise to what the lawyers characterize as a trust) and of the trustee's fraudulent design," because the Privy Council in the *Royal Brunei* case cannot have "intended to suggest that an accessory can be made accountable to the beneficiaries as a constructive trustee regardless of whether he had any knowledge of the trust."

Whether these various findings are desirable in themselves can be debated. But none is compelled by the fact that liability for dishonest assistance derives from the imposition of a trust on property in the defendant's hands. To the extent that the language of constructive trusteeship has led the courts to think otherwise, we would be better off without it.

Recently, in *Bank of Scotland v A Ltd*,[57] the Court of Appeal successfully avoided this pitfall. The appellant bank had received information from criminal intelligence agencies that one of the bank's customers was under investigation, and that money which the customer had placed in its account might be the proceeds of fraud. Once it has received information of this kind, a bank is caught in a cleft stick: if it freezes the customer's account, it may expose itself to an

[50] See too *Arab Monetary Fund v Hashim (No 9)* (Ch D 29 July 1994), where Chadwick J held that the courts should not be misled by the language of constructive trusteeship when identifying the appropriate choice of law rule for a dishonest assistance claim in the conflict of laws, and stressed that in this context "the question whether or not . . . any . . . relevant foreign law . . . recognises the concept of proprietary rights under a trust is irrelevant."

[51] *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643, 671 (Toulson J), echoed in *Bank of Scotland v A Ltd* [2001] 1 WLR 751, 761 (per curiam).

[52] QBD (Comm Ct) 22 January 1999.

[53] [2000] 1 Lloyd's Rep 486, 491–2.

[54] For discussion, see part C, section (2)(b) below.

[55] [2001] QB 113, 144–150. For discussion, see Mitchell, n 39 above.

[56] The Times 23 October 1995. For discussion, see part C, section 4(d) below.

[57] [2001] 1 WLR 751. Lord Woolf CJ spoke for the whole court; the other members of the court were Judge and Robert Walker LJJ.

action for breach of contract,[58] and it may also incur "tipping-off" liability under the Criminal Justice Act 1988, section 93D; if it lets the customer take money out of the account, it may expose itself to a possible action for dishonest assistance if it turns out that the money was indeed the proceeds of fraud,[59] and it may also fall foul of section 93A of the 1988 Act, which prohibits assisting another to retain the benefit of criminal conduct. The bank in the present case therefore applied to Lightman J for directions, in private and without notice to the customer, and he granted the bank an interim injunction against the customer, restraining it from paying money out of the account.[60]

Unfortunately, this proved to be a false move. The customer got wind of what was going on when the bank refused to allow withdrawals from the account without explanation, and various manoeuvrings followed, during the course of which the legal costs mounted and the bank became increasingly alarmed by the prospect that it would be unable to recoup these costs from the customer, against whom no wrongdoing was ever proved. Eventually, Laddie J discharged Lightman J's order on the grounds that it could no longer serve any useful purpose, and that in principle it should never have been granted in the first place. To the bank's dismay, he also ordered the bank to pay the customer's costs, and held that Lightman J's order had been subject to an implied cross-undertaking as to damages.[61]

The bank appealed, and its appeal was dismissed. The Court of Appeal upheld Laddie J's conclusion that the injunction should never have been granted, as it considered that the bank should instead have sought directions from the Serious Fraud Office in the first instance. Had the SFO and the bank then been unable to agree on an appropriate course of action, the bank should have applied to the court for directions, making the SFO rather than the customer the defendant to its application.

For present purposes, the interest of this case arises out of the bank's argument that because it might have been held liable "as a constructive trustee" to the postulated victims of its customer's suspected fraud, "it had acted reasonably in invoking the court's jurisdiction to give guidance and directions to trustees."[62] As has been said, their Lordships did not agree that on the facts the bank had formulated its request for the court's instructions in an appropriate way.[63] They also considered that the courts' powers to grant declaratory relief under the Civil Procedure Rules, part 40.20, are sufficiently developed to make it unnecessary for a party to litigation to show that it possesses the status of trustee before it can obtain such

[58] As in eg, *TTS International v Cantrade Private Bank* (Royal Ct of Jersey 1995), noted D Banks (1995) 4 JITCP 60.
[59] As in eg, *Nanus Asia Co Inc v Standard Chartered Bank* [1990] 1 HKLR 396, 419 (Cruden DHCJ), holding that a bank which received an insider trader's profits might be fixed with liability for dishonest assistance if it released the funds from his account after it had been informed by the New York Security Exchange Commission that he was under investigation for insider trading.
[60] 16 November 1999.
[61] *The Bank v A Ltd* [2000] Lloyd's Rep Bank 271.
[62] *Bank of Scotland* (n 57 above) 762 (per curiam).
[63] *Bank of Scotland* (n 57 above) 765.

relief.[64] But still, their Lordships considered the argument made by the customer's counsel, that the bank could not have fallen within the scope of the courts' jurisdiction to direct trustees because it "was not formally constituted as a fiduciary, nor was there any identifiable trust property as to which the court could give instructions."[65] Their Lordships' reply was essentially to accept the formal truth of these statements but to hold that equity's jurisdiction was sufficiently flexible to come to the bank's aid nonetheless:[66]

> if the bank had such strong grounds for doubting its customer's honesty that it would itself have been dishonest to turn a blind eye to its doubts, then there was a clear risk of the bank incurring liability in equity as an accessory to breach of trust. A bank in that dilemma ought to be able to invoke equity's assistance. The fact that the bank was not formally constituted a trustee . . . ought not to be an insuperable obstacle.

## 2 Dishonest Assistance, Knowing Receipt, and Inducement

Peter Birks' Chapter in this collection[67] is another important contribution to the ongoing debate concerning the nature of liability for knowing receipt.[68] In his view, the courts should recognize that a recipient of misapplied trust funds can be fixed with personal liability towards the beneficiaries on at least two distinct bases: he can owe a strict liability founded upon unjust enrichment, and a fault-based liability founded upon wrongdoing. The arguments supporting this position are compelling, although other positions have also been taken. However, we need not revisit that debate here. For present purposes it is enough to note that if Birks is right, then his argument has implications for the law governing dishonest assistance as well, since it requires us to reassess the question, how liability for knowing receipt is related to liability for dishonest assistance—and liability for inducing a breach of trust, too, since assistance and inducement are clearly connected, and indeed on one view inducement is simply a particular kind of assistance.[69]

[64] *Bank of Scotland* (n 57 above) 764 and 767–8. At 768, their Lordships added that "it seems almost inconceivable that a bank which takes the initiative in seeking the court's guidance should subsequently be held to have acted dishonestly so as to incur accessory liability."
[65] *Bank of Scotland* (n 57 above) 763.
[66] *Bank of Scotland* (n 57 above) 764.
[67] See Ch 7.
[68] Other recent contributions are: L D Smith "W(h)ither Knowing Receipt?" (1998) 114 LQR 394; Lord Nicholls "Knowing Receipt: The Need for a New Landmark" in W R Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Publishing Oxford 1999) 231; L D Smith "Unjust Enrichment, Property, and the Structure of Trusts" (2000) 116 LQR 412; R B Grantham and C E F Rickett, *Enrichment and Restitution in New Zealand* (Hart Publishing Oxford 2000) 281–90.
[69] *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [1999] BCC 669, 676 (Carnwath J) (not considered on appeal, [2001] Ch 437): "Liability for dishonest assistance arises where a person dishonestly *procures or assists in* a breach of trust or fiduciary obligation by another" (my emphasis). Cf *Watson v Dolmark Industries Ltd* [1992] 3 NZLR 311, 316 (Cooke P), describing the situation where a company director instigates the company's breach of fiduciary duty to a third party as "the clearest possible case of knowing assistance"; *Aequitas Ltd v Sparad No 100 Ltd*

The most recent judicial pronouncement on this subject is the Court of Appeal's obiter statement in *Grupo Torras SA v Al-Sabah (No 5)*, that:[70]

The basis of liability in a case of knowing receipt is quite different from that in a case of dishonest assistance. One is a receipt-based liability which may on examination prove to be either a vindication of persistent property rights or a personal restitutionary claim based on unjust enrichment by subtraction; the other is a fault-based liability as an accessory to a breach of fiduciary duty.

On this view, there is no intimate connection between knowing receipt and dishonest assistance, as one is wrong-based and the other is not. But if Birks is right, then it immediately becomes very tempting to say that liability for dishonest assistance, liability for dishonest procurement, and liability for knowing receipt to the extent that this is wrong-based, are all aspects of a single equitable wrong of interfering with another's equitable property rights. This might be dubbed "equitable conversion," with the rider that it is a fault-based wrong, and so provides equitable property owners with less protection than their common-law counterparts—as indeed one might expect.

On this analysis, a defendant who dishonestly receives trust property might not always be personally liable in unjust enrichment, as if he receives the property ministerially he might rely on that fact in his defence to a restitutionary claim.[71] But he *will* always be liable as an "equitable converter"—and not only for the amount which he received, but for the amount of the claimant's loss, if that is greater. This might happen, for example, if the defendant receives half of the claimant's 60 per cent shareholding in a company, which shares are worth less to the defendant (as a minority holding) than they are to the claimant (as the difference between a minority holding and a majority holding).[72] Again, it may be that this is what was really going on in a very recent Canadian case, *Treaty Group Inc v Simpson*,[73] where the claimant company successfully pursued an action for "knowing receipt," and was awarded "aggravated damages" over and above the amount of money which it had lost, to compensate it for the loss of profits which it had sustained when its employees' time and energy

*(formerly Australian European Finance Corp Ltd)* [2001] NSWSC 14 (Austin J): "Lord Selborne referred to an agent who 'assists' in a dishonest and fraudulent design [in *Barnes v Addy* (1874) LR 9 Ch App 244, 251–2]. But if a stranger can be said to have procured or knowingly induced the fiduciary's wrongdoing, the case against the stranger is even stronger."

70 [2001] Lloyd's Rep Bank 36, 62 (per curiam).

71 For discussion, see part C, section 3(d), below.

72 Lord Nicholls "Knowing Receipt: The Need for a New Landmark" in W R Cornish et al (eds) *Restitution: Past, Present and Future* (Hart Publishing Oxford 1999) 231, 244: "in the case of dishonest recipients, liability is not confined to the value of the property received." Lord Nicholls does not expand on this observation in his article, but the example given in the text was used by Lord Nicholls himself to illustrate his proposition, when presenting the paper on which his article is based to a conference in Cambridge in 1998. This argument marks a departure from his Lordship's previous statement in the *Royal Brunei* case, (n 1 above) 386, that "different considerations apply to [liability for knowing receipt and liability for dishonest assistance because] recipient liability is restitution-based [and] accessory liability is not."

73 (2001) 103 ACWS (3d) 1072, paras 29–31.

were diverted from their usual duties into unravelling the primary wrongdoer's fraud.

Having sketched out this picture of how the law relating to dishonest assistance might develop, we must add straight away that there are also other ways in which the law in this area might work out. In particular, we should note that in a series of recent cases, which are discussed below in part C, section (2)(b), the English courts have divided over the question whether it is a prerequisite for liability as a dishonest assistant that the primary breach of duty in which a defendant has dishonestly assisted has itself entailed a misapplication of funds. If the answer to this question turns out to be "yes", then that would be consistent with the view that dishonest assistance forms part of a larger wrong of "equitable conversion." If the answer turns out to be "no", then there are two possibilities. Dishonest assistance might develop into a form of secondary liability for all kinds of equitable wrongdoing, including but not limited to breaches of trust and other fiduciary duties—in which case Equity would have to decide whether it wished to emulate the parsimonious attitude taken by the common law towards secondary liability for breach of contract and tort.[74] Alternatively, dishonest assistance might fragment into two types of liability: primary liability for "equitable conversion," and secondary liability for participating in equitable wrongdoing.

## C THE COMPONENTS OF A CLAIM

### 1 The Parties

#### *(a) The Claimant*

Where a defendant has dishonestly assisted in a breach of trust, the question arises whether the beneficiaries or the trustees are the appropriate claimants in an action for dishonest assistance. Where a defendant has dishonestly assisted in a breach of fiduciary duty owed to a company by its directors or other employees, the question arises whether the shareholders rather than the company might ever have standing to sue. These two questions will be dealt with in turn.

It is clear that either the trustees or the beneficiaries can sue a third party for dishonestly assisting in a breach of trust.[75] Moreover, it is no bar to a trustee's action that he was himself the trustee in whose breach the third party assisted, provided that the wrongdoing trustee in such a case is required to prove his cause

[74] Further reading: P Sales "The Tort of Conspiracy and Civil Secondary Liability" (1990) 49 CLJ 491; D Cooper *Secondary Liability for Civil Wrongs* (Unpublished PhD thesis, University of Cambridge, 1995); M Tugendhat "Assisting in a Breach of Duty by a Fiduciary, the Common Law, and Money-Laundering" in F D Rose (ed) *Restitution and Banking Law* (Mansfield Press Oxford 1998) 135; H Carty "Joint Tortfeasance and Assistance Liability" (1999) 19 LS 489.

[75] *Young v Murphy* [1996] 1 VR 279, 281 (Brooking J); *McMahon v Livingstone* [2001] NSWSC 55, para 49 (Windeyer J) Cf *Fried v National Australia Bank Ltd* [2001] FCA 907, paras 180 ff (Gray J).

of action against the defendant and is not permitted simply to rely upon his own version of events. This may seem a curious rule, especially in those jurisdictions which continue to insist that the breach of trust must have been dishonest and fraudulent before an action in dishonest (or "knowing") assistance will lie. But it must be recalled that the right to sue a third party for dishonest assistance is itself a trust asset, and that it is the continuing duty of a trustee—even a wrongdoing trustee—to act in the beneficiaries' best interests by converting this chose in action into a money award designed to make good the beneficiaries' losses or to strip the defendant of his profits.[76] Moreover, as Ungoed-Thomas J held in *Selangor United Rubber Estates Ltd v Cradock (No 3)*:[77]

> In a claim based on an illegal breach of trust [a claimant trustee] does not rely on a right conferred or created by that breach. On the very contrary, he relies on a right breached by the breach, as the very words "breach of trust" indicate. . . . The breach of trust includes the making of the plaintiff a party to the illegal transaction. So . . . on analysis . . . the plaintiff is not precluded from relying on a breach of trust by a party to an illegal transaction, to which the plaintiff itself is a party, when the breach includes the making of the plaintiff a party to that very transaction.

This analysis suggests that Tipping J may have slightly over-complicated matters in a case in the New Zealand High Court, *Marshall Futures Ltd v Marshall*.[78] Here, it was argued that a corporate trustee could not be the proper claimant in an action for dishonest assistance against its own corporate officers, because it would have to rely upon its own fraudulent breach of trust in order to make out its claim. The defendants argued that in these circumstances, the claim should vest in the beneficiaries. Since the breach of trust, however, the company had gone into liquidation, and Tipping J held that it would be appropriate to lift the corporate veil to reveal the liquidator behind the company's action, whose role was to represent the company's creditors and whose own hands were not unclean. He therefore refused to strike out the proceedings, and allowed them to continue with the proviso that the defendants would not be bound by any concession made by the claimant company with regard to its own behaviour.

So far as the beneficiaries are concerned, we may note that allowing them to sue dishonest assistants runs counter to the orthodoxy that a beneficiary cannot sue anyone but his trustee, an orthodoxy which in Lionel Smith's words lies "in

[76] *Young v Murphy* (n 75 above) 282–3 (Brooking J) and 297 (J D Phillips J), followed in *Koorootang Nominees Pty Ltd v Australia and New Zealand Banking Group Ltd* [1998] 3 VR 16, 75–6 (Hansen J). The principle is also extended to constructive trustees in: *Brink's Mat Ltd v Noye* [1991] 1 Bank LR 68, 72 (Mustill LJ); *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 545–7 (Smellie J); *Casio Computer Co Ltd v Sayo* The Times 6 February 2001, transcript, para 25 (Anthony Mann QC), affirmed on another point [2001] EWCA Civ 661. *Quaere* whether this analysis is consistent with Lord Nicholls' statement in the *Royal Brunei* case (n 1 above) 392, that a dishonest trustee cannot sue a third party for negligently failing to detect the trustee's own dishonesty, as the trustee would personally suffer no loss from this failure?

[77] [1968] 1 WLR 1555, 1656, followed in *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 523 (Smellie J).

[78] [1992] 1 NZLR 316.

the logic of the trust," because restricting beneficiaries to the right to hold their trustees to account "is part of the package of legal incidents which is delivered when parties choose to use the trust institution to order their affairs."[79] Smith also observes in an illuminating passage that:[80]

> if the beneficiary finds a defendant who has received trust property in such a way that it remained subject to the trust, then the defendant is a trustee of that property for the beneficiary, and so the action for an appropriate declaration and consequential relief is an action against the trustee. But if the beneficiary is trying to make a defendant personally liable for something the defendant has done, it is not so easy. The defendant does not now hold, perhaps never has held, property on trust for the plaintiff. And here the logic of [fixing the defendant with liability to account "as a constructive trustee"] comes into its own . . . [for this] is not to allege that the defendant really is a trustee, nor that he ever was, nor that there is or ever was a constructive trust; it is simply to allege that the defendant should be personally liable to the plaintiff, who is (supposedly) only allowed to sue his trustee.

Turning to the second question, our starting point must be the Court of Appeal's decision in *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)*.[81] This case was recently reviewed by the House of Lords in *Johnson v Gore Wood & Co (a firm)*,[82] and was affirmed there by a majority of their Lordships on the basis that it stands for the following propositions.[83] (1) In situations where a company suffers loss as a result of an actionable breach of duty owed to the company, the cause of action in respect of this breach of duty is vested in the company, and the company alone can sue in respect of it, although exceptionally a shareholder may be permitted to bring a derivative action to enforce the company's right on the company's behalf, and so recover damages or equitable compensation for the company.[84] (2) This rule does not apply where the value of a shareholder's shares is reduced as a result of a breach of duty which is owed to him personally, and where no breach of duty to the company has been committed, as in these circumstances the shareholder has an independent cause

[79] L D Smith "Constructive Trusts and Constructive Trustees" (1999) 58 CLJ 294, 299.
[80] "Constructive Trusts and Constructive Trustees" (n 79 above) 300.
[81] [1982] Ch 204.
[82] [2001] 2 WLR 72. For discussion of the tricky question whether the principles set down in *Johnson v Gore Wood & Co (a firm)* debar a shareholder from suing a defendant for reflective loss where the defendant has a good defence to the company's claim, see *Barings plc (in liq) v Coopers and Lybrand (a firm)* [2001] EWHC Ch 461, paras 89 ff (Evans-Lombe J), considering Arden LJ's dissenting judgment in *Day v Cook* [2001] Lloyd's Rep PN 551.
[83] *Johnson v Gore Wood & Co (a firm)* (n 82 above) 94–5 (Lord Bingham) and 120–2 (Lord Millett). At 100, Lord Goff agreed with Lord Millett. At 104 and 114 respectively, Lord Cooke and Lord Hutton also affirmed the *Prudential Assurance* case, but they disagreed with the others over the question whether the decision in the *Prudential Assurance* case is consistent with the NZCA's decision in *Christensen v Scott* [1996] 1 NZLR 273. This difference of opinion led them to part company with the others over proposition (5) in the text. This is discussed further in n 88 below.
[84] *Johnson v Gore Wood & Co (a firm)* (n 82 above) 94 (Lord Bingham), following *Prudential Assurance* (n 81 above) 222–3 (per curiam); *Heron International Ltd v Grade* [1983] BCLC 244, 261–2 (per curiam); *George Fischer (Great Britain) Ltd v Multi Construction Ltd* [1995] 1 BCLC 260, 266 (Glidewell LJ); *Gerber Garment Technology Inc v Lectra Systems Ltd* [1997] RPC 443; *Stein v Blake* [1998] 1 BCLC 573, 577–9 (Millett LJ).

of action and the company has none.[85] (3) Nor does it apply "where a company suffers loss caused by a breach of duty to it, and a shareholder suffers a loss separate and distinct from that suffered by the company caused by a breach of duty independently owed to the shareholder," as in these circumstances "each may sue to recover the loss caused to it by breach of the duty owed to it but neither may recover loss caused to the other by breach of the duty owed to that other."[86] (4) However, the rule does apply where no breach of duty has been committed against the shareholder personally, as in these circumstances he has no cause of action in his own right, even though the effect of the breach of duty to the company is to reduce the value of his shareholding by causing a loss to the company.[87] (5) It also applies where the company and the shareholder are each owed a separate duty by a defendant whose breach of duty to the shareholder only causes him a "reflective loss," ie, a reduction in the value of his shareholding that reflects the diminution in value of the company's assets which has been caused by the defendant's breach of duty to the company.[88]

It follows from all this that where a breach of fiduciary duty has been committed against a company by a director, the company is almost always the proper person to sue in respect of the actions or omissions which constitute this breach of duty. The only possible exception to this general rule is where the actions or omissions of the director have simultaneously constituted a breach of duty to the company and a separate breach of duty to a shareholder that has caused the shareholder a loss other than a reflective loss. Thus, in *Re Lucking's WT*,[89] for example, a company shareholder was also the beneficiary of a trust whose assets included further shares in the company, and she successfully sued her trustees for

[85] *Johnson v Gore Wood & Co (a firm)* (n 82 above) 121 (Lord Millett), following *Lee v Sheard* [1956] 1 QB 192, 195–6 (Denning LJ); *George Fischer* (n 84 above); *Gerber* (n 84 above).

[86] *Johnson v Gore Wood & Co (a firm)* (n 82 above) 94–5 (Lord Bingham), taking this to be the effect of *Lee v Sheard* (n 85 above) 195–6 (Denning LJ); *Heron* (n 84 above) 262 (per curiam); *R P Howard Ltd v Woodman Matthews and Co (a firm)* [1983] BCLC 117, 123 (Staughton J); *Gerber* (n 84 above); *Stein* (n 84 above) 577–9 (Millett LJ).

[87] In the case of a small private company, the diminution of the company's assets may correspond quite closely to the diminution in value of the shares; in the case of a company whose shares are publicly traded, the correspondence may well not be so close, as the value of the shares is likely to be affected by market sentiment as well as the value of the company's underlying assets and trading prospects.

[88] *Johnson v Gore Wood & Co (a firm)* (n 82 above) 95 (Lord Bingham) and 124–5 (Lord Millett), both overruling *Barings plc (in admin) v Coopers & Lybrand (a firm)* [1997] 1 BCLC 427, 435 (Leggatt LJ) and refusing to follow *Christensen v Scott* [1996] 1 NZLR 273, 280 (Thomas J), where it was said that a shareholder might sue in respect of a breach of duty owed to him personally by a defendant who had also breached a duty owed to the company, even if the loss suffered by the shareholder reflected a diminution of the company's assets caused by the defendant's breach of duty to the company. At 104–5, Lord Cooke, who had been a member of the NZCA in *Christensen*, denied that the court's decision there was contrary to principle, and stressed that Thomas J had recognized that double recovery should not be permitted. The NZCA's decision is also supported at 113–4 by Lord Hutton, but as Lord Goff agreed with Lord Millett, the NZCA's analysis in *Christensen* was rejected by a 3:2 majority. As a matter of Australian law, however, some support for *Christensen* might be derived from *Waterhouse v Waterhouse* (NSW Sup Ct (Eq Div) 4 June 1998) paras 102–5 (Windeyer J), following *Re Auditore's Will* 164 NE 242 (1928).

[89] [1968] 1 WLR 866.

failing to prevent the managing director of the company from misappropriating corporate assets. One of the trustees was also a director of the company, whose failure to prevent the managing director's misfeasance had also constituted an actionable breach of duty to the company, but this was not thought to debar the beneficiary's action. *Re Lucking's WT* was recently affirmed by the Court of Appeal in *Walker v Stones*,[90] where their Lordships reached essentially the same conclusion on more complex facts.

The question also arose in *Walker v Stones*, whether the beneficiaries of a trust whose assets included shares in various companies could bring an action for dishonest assistance against a defendant who had assisted breaches of fiduciary duty by the company directors. Sir Christopher Slade held that they could not, in terms which suggest that in practice beneficiaries will find it very hard, if not impossible, to persuade a court that they should ever be entitled to do this:[91]

> In the light of the *Prudential Assurance* principle, it is . . . necessary to consider whether [the alleged dishonest assistant's] assumed conduct would have caused [the beneficiaries] personal loss separate and distinct from any loss which it caused to [the companies]. In my judgment it plainly did not. In defending [the beneficiaries'] claims in reliance on the *Prudential Assurance* principle, [the alleged dishonest assistant] is in a position quite different from that of the trustees, who are faced with claims based on the *Re Lucking's WT* principle. The causes of action on which the beneficiaries would have to rely as against [the dishonest assistant] would necessarily have to be the same causes of action as those on which the . . . companies would rely. They would involve investigation of precisely the same facts and would be based on the same facts. The proper plaintiffs in respect of these causes of action against [the dishonest assistant] would be the companies themselves.

A further case on this issue, from Canada, is *Hanson v Clifford*.[92] Here, a derivative action and a personal action were both brought at the instigation of a shareholder in respect of breaches of fiduciary duty by a company director and his wife, and also in respect of the wife's dishonest assistance in the husband's breaches of duty. Errico J awarded damages against both husband and wife in the derivative action, and then went on to hold that:[93]

> the claim for damages in the personal action is subsumed in the amounts awarded in the derivative action. To award the damages sought in the personal action would allow [the shareholder] to recover again personally what he will in effect recover in the increase in value of his shareholdings in [the company] by reason of the award to [the company in the derivative action].

[90] [2001] QB 902, 953 (Sir Christopher Slade).
[91] *Walker v Stones* (n 90 above), 671. See too *Shaker v Al-Bedrawi* [2001] EWHC Ch 159, esp paras 149–150 (Lawrence Collins J).
[92] (1994) 59 CPR (3d) 465. See too *Watson v Imperial Financial Services Ltd* (1984) 88 BCLR (2d) 88, considered in *Jiwan v Jiwan* (British Columbia Sup Ct 15 February 2001) paras 34–42 (Clancy J); *Lederer v Fenwick* (Ontario Sup Ct 3 August 2001), where Master Macleod struck out a claim that the defendant in his capacity as trustee had assisted himself to commit breaches of fiduciary duty in his capacity as director of a company, shares in which constituted the trust property.
[93] *Hanson v Clifford* (n 92 above) 509–510.

However, as the defendants had not argued that the personal action should be dismissed for this reason, Errico J found it unnecessary to decide whether that would be the appropriate course for him to take, and contented himself with awarding nominal damages in the personal action.

### *(b) The Defendant*

Where a breach of trust or other fiduciary duty has been committed, and a claimant wishes to sue a particular person for dishonest assistance, the question arises whether the claimant may sue this person as the sole defendant to his action, or whether he must join anyone else to the action as a co-defendant. According to circumstances, he might also be entitled to sue the primary wrongdoer, his fellow trustees or fiduciaries, other dishonest assistants, knowing recipients of the trust property, or indeed anyone else against whom he has a claim in connection with the primary breach. However, it is clear that any liability which these parties might owe to the claimant is a joint and several liability,[94] with the result that the claimant can choose to sue whichever of them he likes.[95] As discussed in the next section, liability for dishonest assistance is contingent on a primary breach of duty having been committed, but it does not even follow from this that the claimant must sue the primary wrongdoer before he can sue the dishonest assistant.[96] It is of course open to the dishonest assistant to join any or all of the others to the action as third parties under CPR Part 20, with a view to recovering a contribution or reimbursement from them in the event that he is found liable, but that is a different matter.[97]

## 2 The Primary Breach

### *(a) The Need for a Primary Breach*

In the *Royal Brunei* case, Lord Nicholls stated that liability for dishonest assistance "is a form of secondary liability in the sense that it only arises where there

[94] *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295, 323 (Manson J); *Efstratiou v Glantschnig* [1972] 1 NZLR 594, 599 (Turner J); *D'Amore v Macdonald* (1973) 32 DLR (3d) 543, 549 (Addy J); *Abbey Glen Property Corp v Stumborg* (1976) 65 DLR (3d) 235, 281–3 (McDonald J); *MacDonald v Hauer* (1976) 72 DLR (3d) 110, 130 (Bayda JA); *Winslow v Richter* (1989) 61 DLR (4th) 549, 563 (Wood J); *Hanson v Clifford* (1994) 59 CPR (3d) 465, 504 (Errico J); *Young v Murphy* [1996] 1 VR 279, 300 (J D Phillips J); *Somes v Duke Group Ltd* [2000] FCA 248, para 17 (von Doussa J); *Montreal Trust Co of Canada v Hickman* [2001] NFCA 42, para 43 (Green JA); *Trustor AB v Smallbone* (CA 9 May 2000) para 97 (Scott V-C); *Comax Secure Business Services Ltd v Wilson* (QBD 21 June 2001); *Capital Investments Corp v Classic Trading Pty Ltd* [2001] FCA 1385; *Baker Petrolite Corp v Canwell Enviro-Industries Ltd* (2001) 13 CPR (4th) 193.

[95] *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 257–8 (Huband JA), rejecting an argument that an action for dishonest assistance should be struck out on the ground that the claimant had previously brought an unsuccessful action arising out of the same breach of trust, against a knowing recipient.

[96] *Chan Kern Miang v Kea Resources Pte Ltd* [1999] 1 SLR 145, esp 151 (per curiam).

[97] Discussed in Mitchell, n 41, above.

has been a breach of trust,"[98] and consistently with this, the courts have systematically absolved defendants from liability who have not assisted in activities by a trustee or other fiduciary which have themselves entailed a breach of duty to the claimant. So, in *Goose v Wilson Sandford & Co (No 2)*,[99] for example, the Court of Appeal held that a chartered accountant was not liable for dishonest assistance where none of the assistance he had given to a fraudster had been given in connection with the fraudster's sole breach of fiduciary duty to the claimant; and again, in *News Ltd v Australian Rugby Football League Ltd*,[100] the Full Court of the Federal Court of Australia held that the appellant television company was not liable for dishonest assistance where it had recruited rugby league clubs to a proposed new rugby league competition, as the clubs had owed no fiduciary duty to the respondent rugby league body.

Even where a claimant can show that a defendant has dishonestly assisted in a primary breach, he still has some work to do. For, depending on the remedy he seeks, he must also show that the primary breach has caused him a loss, or that the dishonest assistant has been enriched as a consequence of the primary breach, or that the primary wrongdoer or indeed anybody else has been so enriched. Authority for the first of these propositions is *Brown v Bennett (No 2)*,[101] in which Neuberger J struck out a claim in dishonest assistance on the ground (inter alia) that even if the claimants had made out a prima facie case that the defendants had assisted in a breach of duty by some company directors, they had failed to establish that these breaches had caused the damage complained of, which would have happened anyway. Authority for the second proposition is *Fyffes Group Ltd v Templeman*,[102] in which Toulson J suggested that in principle a claimant can have an account of profits against a dishonest assistant who has enriched himself by his equitable wrongdoing, regardless of whether the primary breach has caused the claimant a loss. Again, in his first instance decision in a well-known Australian case, *United States Surgical Corp v Hospital Products International Pty Ltd*, McLelland J held that:[103]

> a person who knowingly participates in a breach of fiduciary duty by another may be both (i) liable to account to the beneficiary for any benefit he has received as a result of such participation and (ii) jointly liable with the fiduciary in respect of any pecuniary liability of the fiduciary to the beneficiary as a result of the breach.

[98] *Royal Brunei* (n 1 above) 382.
[99] CA 14 March 2000.
[100] (1996) 64 FCR 410. See too *Miranda v Hardovin* (British Columbia CA 3 May 1996) para 16 (Finch JA); *National Mutual Property Services (Australia) Pty Ltd v Citibank Savings Ltd* (Fed Ct Aus 28 May 1998), where Lindgren J held that a bank whose agent had also acted as agent for investors in a unit trust scheme could not be liable for assistance where the agent had breached no fiduciary duty to the investors.
[101] Ch D 18 October 2000.
[102] [2000] 2 Lloyd's Rep 643, esp 660–668. On the facts of this case, the claimant's loss and the defendant's gain were the same.
[103] (1982) 2 NSWLR 766, 817.

The latter part of this statement leads us to our third proposition, authority for which can also be found in several other cases, including *Comax Secure Business Services Ltd v Wilson*,[104] in which Judge Richard Seymour QC recently held that a primary wrongdoer, a dishonest assistant, and a third party which had knowingly received the profits of the primary wrongdoer's breach of fiduciary duty, were all jointly and severally liable to account for these profits, and that so far as the liability of the first two was concerned, it was "nothing to the point . . . that . . . [they] may have been content that [the third party] should enjoy the entire fruits of this particular breach of fiduciary obligation."

The question does not appear to have been tested in the courts, whether a defendant might be liable for dishonest assistance in a breach of trust where the trustee is protected by an exemption clause. Exemption clauses come in two flavours: those which exclude liability for breach of duty,[105] and those which absolve him from duty in the first place.[106] Both kinds of clause can work in an "all or nothing" way, so that the clause excludes all liability for particular types of breach, or they can work on a sliding scale according to the degree of the trustee's fault. Since Lord Nicholls held in the *Royal Brunei* case that liability for dishonest assistance can be incurred regardless of the degree of the trustee's fault, nothing seems to turn on the latter distinction for present purposes. However, the former distinction might be important. For if the trustee were protected by a clause of the second kind, absolving him from duty, then the defendant in a dishonest assistance case might argue that he should escape liability on the ground that no primary breach of duty had ever been committed; and in contrast, this argument should not be open to him if the trustee were only protected by a clause of the first kind, excluding liability for breach of duty.

Even in this first kind of case, however, a defendant might conceivably escape liability on the ground that dishonest assistants are jointly and severally liable with the wrongdoing trustees or fiduciaries whose breaches of duty they assist,[107] with the consequence that the release of the trustee or fiduciary should also operate to release those with whom he is jointly and severally liable. This is discussed further in part D, section (1), below.

[104] QBD 21 June 2001. See also *Canada Safeway Ltd v Thomson* [1951] 3 DLR 295, 323 (Manson J), considered in *Moage Ltd v Jagelman* [2001] NSWSC 557, and followed in: *D'Amore v Macdonald* (1973) 32 DLR (3d) 543, 549 (Addy J), aff'd (1974) 40 DLR (3d) 345; *Abbey Glen Property Corp v Stumborg* (1976) 65 DLR (3d) 235, 282 (McDonald J), aff'd (1978) 85 DLR (3d) 35, subseq proceedings, Alberta QB 2 February 1983; *Osman Auction Inc v Belland* [1999] ABQB 589. See too *Trustor v Smallbone AB* (CA 9 May 2000) para 97 (Scott V-C), where it is clear that the Vice-Chancellor considered the defendant to be jointly and severally liable as a dishonest assistant for all the gains made by a knowing recipient of money paid away in breach of fiduciary duty, and that this joint and several liability "would not be confined to the part that he personally received"; with respect, Scott V-C's finding on this point does not seem to have been quite understood by Morritt V-C in subsequent proceedings: *Trustor AB v Smallbone (No 2)* [2001] 1 WLR 1177, 1186 (cf comments below at n 161).

[105] As in eg, *Armitage v Nurse* [1998] Ch 241.

[106] As in eg, *Hayim v Citibank* [1987] AC 230.

[107] See the cases cited in n 94, above.

Finally, though, we must note Simon Gardner's suggestion that "one might . . . query whether a breach of trust should be necessary at all."[108] The courts still do not appear to have reviewed Gardner's observations on this point, but they repay some thought. He writes:

> It seems that no breach may be necessary for the analogous liability for interference with contractual relations.[109] Certainly, it would make sense for breach not to be required in the trusts context. If, in the events complained of, the trustees relied on the probity and competence of the defendant, and acted as ordinary prudent businessmen in doing so, they will often not be liable for breach.[110] Yet if the defendant acted dishonestly, as the law now requires, he has just as much harmed the jural rights comprising the trust as if there were a breach.

The reason why this argument has not been run in the cases to date is perhaps that trustees and beneficiaries do not need to sue third parties for dishonest assistance where they have been employed by the trustees to carry out some piece of trust business, as in these circumstances the trustees can readily sue the third parties for breach of contract or tort.

### *(b) Breach of What Duties?*

It is clear that claims for dishonest assistance are not limited to the situation where the primary breach has entailed the misappropriation of trust property by an express trustee, and that they also lie against those who assist in the misappropriation of property by other fiduciaries who have voluntarily assumed responsibility towards their principals—for example, partners,[111] company directors,[112] and other agents and/or employees.[113] Beyond these propositions,

[108] S Gardner "Knowing Assistance and Knowing Receipt: Taking Stock" (1996) 112 LQR 56, 68.

[109] Citing Lord Denning MR's judgment in *Torquay Hotel Co Ltd v Cousins* [1969] 2 Ch 106.

[110] Citing *Speight v Gaunt* (1883) 22 Ch D 727; (1883) 9 App Cas 1. See now the Trustee Delegation Act 1999 and the Trustee Act 2000, esp ss 1, 11, 12, and Sched 1.

[111] *Alers-Hankey v Solomon* (British Columbia CA 27 March 2000); subsequent proceedings: British Columbia Sup Ct 8 December 2000. See too *Jiwan v Jiwan* (British Columbia Sup Ct 15 February 2001) esp para 18 (Clancy J).

[112] Company directors have long been said to commit a breach of trust if they misapply the company's assets, even though legal ownership of the assets is vested in the company, with the result that the directors cannot accurately be described as trustees: eg, *Russell v Wakefield Waterworks Co* (1875) LR 20 Eq 474, 479 (Jessel MR); *Re Lands Allotment Co* [1894] 1 Ch 616, 638 (Lindley and Kay LJJ); *Consul Development Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 396 (Gibbs J); *Re Duckwari plc* [1999] Ch 253, 262 (Nourse LJ). The courts are of course aware that technically the directors are not trustees of the company's property: eg, *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134, 147 (Lord Russell), following *Re Forest of Dean Coal Mining Co* (1878) 10 Ch D 450, 451–3 (Jessel MR). But even so, their position is sufficiently similar for the courts to have felt no hesitation in holding that those who assist them to misapply corporate assets can be liable for dishonest assistance: eg, *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, 1574 (Ungoed-Thomas J); *Belmont Finance Corp Ltd v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 405 (Buckley LJ); *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 516 (Nourse LJ).

[113] *Norwich Union Fire Insurance Soc Ltd v Central Auto Salvage (London) Ltd* (CA 30 July 1993) (breach of fiduciary duty by a clerk in the claimant insurance company's motor salvage unit); *Brinks Ltd v Abu-Saleh (No 3)* The Times 23 October 1995 (breach of fiduciary duty by a security guard

however, the law is less certain, and four questions in particular merit our attention: do claims in dishonest assistance lie against those who assist in breaches of fiduciary duty that do not entail the misapplication of property; do they lie against those who assist in breaches of equitable duties which are not fiduciary duties; do they lie against those who assist in the misappropriation of assets held on resulting or constructive trusts; and do they lie against those who assist in a misapplication of property that gives rise to a claim at common law?

So far as breaches of fiduciary duty are concerned, we might have expected the courts to hold that accessory liability should attach to dishonest assistants in all such breaches, consistently with the courts' desire to maintain the integrity of fiduciary relations. But in fact, as we have mentioned already,[114] a split has developed in the English case law, over the question whether accessory liability can be incurred by those who assist in a breach of fiduciary duty that does not entail the misapplication of trust funds or other property subject to a fiduciary obligation. Some supporters of the view that a misapplication of funds is required seem to have reasoned that because liability for dishonest assistance is liability "as a constructive trustee," it can arise only where a trust of property for the beneficiary or principal can be found somewhere in the picture.[115] However, this reasoning is incompatible with the dicta which have also been discussed already,[116] that liability for dishonest assistance is liability "as a constructive trustee" only in the sense that it resembles the liability which the defendant would have owed if he had been a trustee: ie, it is not liability "as a constructive trustee" in the sense that it arises because the dishonest assistant or anyone else is actually a trustee of property for the claimant.

Authorities favouring the narrower view, that the primary breach must have entailed a misapplication of funds, are as follows. In *Cowan de Groot Properties Ltd v Eagle Trust plc*,[117] it was accepted by the parties and apparently also by the judge, Knox J, that the ingredients of a claim for "knowing assistance" included a (dishonest) design on the part of the trustee or fiduciary "relating to the misapplication of trust property." In *Bankgesellschaft Berlin AG v Makris*,[118] it was accepted by the parties and apparently also by the judge, Cresswell J, that the claimant bank would have had to show that it had paid its money under a mistake of fact sufficiently fundamental for an equitable proprietary interest in the

in the claimant's employment); *Colour Control Centre Pty Ltd v Ty* (NSW Sup Ct (Eq Div) 24 July 1995) esp paras 60–63 (Santow J) (breach of fiduciary duty by a company manager); *Humphris v Jenshol* (1997) 25 ACSR 212 (breach of fiduciary duty by a company officer who had ceased to be a director because he was a bankrupt, but who continued to manage the company thereafter); *Comax Secure Business Services Ltd v Wilson* (QBD 21 June 2001) (breach of fiduciary duty by claimant company's sales manager).

114 See part B, section (2), above.

115 *Bankgesellschaft Berlin AG v Makris* (QBD (Comm Ct) 22 January 1999); *Petrotrade Inc v Smith* [2000] 1 Lloyd's Rep 486, 491–2 (David Steel J).

116 See part B, section (1), above.

117 [1991] BCLC 1045, 1103.

118 QBD (Comm Ct) 22 January 1999.

money to have arisen in its favour, before it could have fixed some of the defendants with liability for dishonestly assisting the recipients of the mistaken payments.[119] In his first instance decision in *Goose v Wilson Sandford & Co (No 2)*,[120] Rimer J considered that it would involve an "extension" of accessory liability to hold that it could attach to breaches of fiduciary obligation generally. In *Satnam Investments Ltd v Dunlop Heywood & Co Ltd*,[121] Nourse LJ (delivering the judgment of the Court of Appeal) held that "before a case can fall into either category [ie, knowing receipt or 'knowing assistance'] there must be trust property or traceable proceeds of trust property." In *Petrotrade Inc v Smith*,[122] David Steel J held that a defendant who had bribed the claimant's fiduciary to act in a manner which was contrary to the claimant's interests could not be fixed with liability for dishonest assistance unless the claimant could show that its fiduciary's breach of duty had involved the misapplication of the claimant's property. In *Ansys Inc v Khee*,[123] Park J was happy to assume that "the ingredients which must exist for [accessory] liability to be established are (1) the money which was diverted . . . must have been held . . . on trust for [the claimant]; (2) the diversions of the money must have been breaches of trust . . .; (3) [the defendants] must have assisted in or procured the breach of trust." He concluded on the facts that there was no such trust, and so no accessory liability, although we may note that on the facts the alleged primary wrongdoer clearly owed no other sort of fiduciary duty to the claimant either, as their relationship was governed by the terms of an arm's-length commercial contract.

In contrast, there are several English cases in which the question has been left open, whether accessory liability can arise where a breach of fiduciary duty has been committed that does not entail the misapplication of trust funds—and the High Court of Australia did not appear to be troubled by the point in *Consul Development Pty Ltd v DPC Estates Pty Ltd*.[124] In *Brown v Bennett*,[125] Morritt LJ "would not uphold" Rattee J's finding at first instance that liability for dishonest assistance cannot arise in respect of breaches of

[119] It is unclear from his comments on this point whether Cresswell J thought it necessary for the bank to show that it had an equitable proprietary interest because he thought it needed to prove that a misapplication of trust funds had taken place, or because he thought that it needed to prove that a breach of fiduciary duty had occurred. However, the former interpretation seems to be borne out by his subsequent statement that "the imposition of liability for dishonest assistance confers no right either to equitable compensation or compensation for consequential loss [and the]. . . relevant liability is to account for the property which has been the subject of the misfeasance or breach of trust as though the defendant were a trustee."

[120] Ch D 25 January 1999; aff'd on other grounds, CA 14 March 2000.

[121] [1999] 1 BCLC 385, 404.

[122] [2000] 1 Lloyd's Rep 486, 491–2, adding that it was not a sufficient basis to fix a briber with equitable accessory liability that the principal of a bribed agent is generally presumed to have suffered a loss equating to at least the value of the bribe for the purpose of quantifying the measure of the briber's liability in tort.

[123] Ch D 19 May 1999. See too *Crown Resources v Vinogradsky* (QBD 14 Nov 2001) para 20 (Garland J).

[124] (1975) 132 CLR 373.

[125] [1999] 1 BCLC 649, 657–9.

fiduciary duty by company directors which relate to the management of the company's affairs, but which do not affect the company's property:[126] in Morritt LJ's opinion, there was "force" in the argument that equity should take the wider view, but in the end he found it unnecessary to decide the question. In *Fyffes Group Ltd v Templeman*,[127] another bribery case, the parties seem to have simply assumed that the wider view was correct, and the case was decided by Toulson J on that basis without comment. In the Court of Appeal in *Goose v Wilson Sandford & Co (No 2)*,[128] Morritt LJ (speaking for the whole court) did not regard Nourse LJ's statement in the *Satnam* case as binding on the point, and held that "the formulation of the principle by Lord Nicholls [in the *Royal Brunei* case] does not embrace . . . a requirement [that the breach of trust in which the defendant assisted must have involved the misapplication of trust property or its proceeds of sale] . . . and . . . we would not like to shut out the possibility of such a claim." Again, though, it was unnecessary to decide the issue. Finally, in *Gencor ACP Ltd v Dalby*,[129] Rimer J returned to the point and held that in light of the foregoing decisions he must now regard it as "something of an open question."

The Court of Appeal's recent decision in *Twinsectra Ltd v Yardley*[130] also has some bearing on this issue. Here, the claimant Twinsectra lent money to the first defendant, Yardley, on the basis that it would be applied "solely for the purpose of acquiring property." In the event, Yardley spent it on various other things, and when he failed to repay the loan, Twinsectra sued both him and his solicitor, Leach, who had helped him carry out the relevant transactions. The Court of Appeal held inter alia that the money had been impressed with a *Quistclose*

126 [1998] 2 BCLC 97, 104.

127 [2000] 2 Lloyd's Rep 643. The defendants did run an argument in relation to the *remedial consequences* of liability which was premised on the mistaken view that dishonest assistants incur liability because a constructive trust is imposed on property derived from the claimant; this argument was rightly rejected by Toulson J at 671–2.

128 CA 14 March 2000.

129 [2000] 2 BCLC 734, 757. See too *Banque Nationale de Paris v Hew* [2001] 1 SLR 300, 334–6, where Lai Kew Chai J reviewed the *Satnam Investments* case and the *Goose* case, and concluded that "the head of claim under dishonest accessory liability . . . can in principle be maintained even if there is no mishandling of any trust property or its traceable proceeds of sale provided the assistance causes the loss in question." Unfortunately, it is unclear from this wording whether the judge meant to say that liability for dishonest assistance can be incurred by assistants who have never themselves handled trust property (which is uncontroversial: see the cases cited in n 43), or that it can be incurred by assistants who enable the commission of a primary breach of duty which does not entail the mishandling of trust property by the primary wrongdoer (which is the controversial point discussed in the text).

130 [1999] Lloyd's Rep Bank 438; appeal pending to the House of Lords. Cf *Shenzen City Luohu District Industrial Development Co v Yao* (British Columbia Sup Ct 25 April 2000) esp paras 136–147 and 165–182 (Williams CJSC), holding that an express trust of the claimant's money for a particular purpose had been created, that in breach of trust this money had been used for different purposes, and that one of the defendants was liable for knowingly assisting in this breach. With respect to Williams CJSC, it is hard to square these findings with the rule that trusts for private purposes are void for infringing the beneficiary principle, but perhaps they might be explained on the basis that the claimant's money was impressed with a *Quistclose* trust.

trust,[131] and that Leach was liable for dishonestly assisting Yardley to misapply the money in breach of his duty to Twinsectra. For present purposes, the interest of this case lies in the fact that Potter LJ found Leach liable for dishonest assistance even though he also held that Twinsectra had possessed no present equitable interest in the money at the time when Yardley misapplied it. Rather, Potter LJ was content to say either that Twinsectra had had an equitable interest "in suspense,"[132] or that it had had no beneficial interest in the money at all, but merely a personal right to prevent its misapplication.[133] It would seem to follow that Potter LJ did not regard it as an obstacle to fixing Leach with liability for dishonest assistance that the primary breach committed by Yardley had not involved the misapplication of funds in which Twinsectra had possessed a current beneficial interest.

Andrew Tettenborn has asserted that Potter LJ's findings in relation to Leach's liability raise "few serious difficulties," for the reason that:[134]

> Although many cases of "dishonest assistance" concern funds where the claimant has the beneficial interest at the time of misuse, there is no reason to limit this head of liability to assistance in a breach of trust in the strict sense. Dishonest assistance in the breach of any equitable obligation not to misapply funds of which one [*sc*: the primary wrongdoer] is otherwise beneficial owner, ought equally to attract liability.

The line of authority exemplified by Nourse LJ's dictum in the *Satnam Investments* case, discussed above, suggests that greater difficulties may lie in the way of Tettenborn's analysis than this passage indicates. Nevertheless, his argument is an attractive one in principle.[135]

The equitable duty owed by the borrower of funds impressed with a *Quistclose* trust was regarded by the parties in the *Twinsectra* case as a fiduciary duty, and Potter LJ clearly thought that they were right about this.[136] Hence, the case does not really help us when we turn to our second question, whether liability for dishonest assistance can be incurred by those who assist in breaches of equitable duty which are not fiduciary duties. However, some light is thrown on this second question by the Court of Appeal's decision in *Thomas v Pearce*,[137] although this case, too, raises some tricky problems of classification. It concerned a claim against a recipient of confidential information, which was described by Buxton LJ as a claim of "knowing assistance in the [informant's] breach of confidence." The claim failed on the facts, as the recipient of the information was held not to have acted dishonestly, but

[131] Named after *Barclays Bank Ltd v Quistclose Investments Ltd* [1970] AC 567.
[132] Echoing *Carreras Rothman v Freeman Matthews Treasure* [1985] Ch 207, 233 (Peter Gibson LJ).
[133] Echoing R Chambers, *Resulting Trusts* (Clarendon Press Oxford 1997) 74.
[134] A Tettenborn "*Quistclose* Trusts, Fraud and Third Parties" [2000] LMCLQ 459, 461, n 12 and text.
[135] The Court of Appeal's findings in relation to Leach's liability also raise the question whether it should be enough to fix a defendant with liability for dishonest assistance that he has known of the facts which give rise to the primary wrongdoer's liability, without appreciating their legal significance. This question is considered below in section 4(d).
[136] *Twinsectra Ltd v Yardley* (n 130 above) 454 (Potter LJ).
[137] CA 10 February 2000.

we may note that Buxton LJ approved the following statement of law in Toulson and Phipps' book on confidentiality:[138]

> Where the third party receives information knowing that it has been disclosed by his informant in breach of confidence, he will himself owe a duty of confidence to the confider. This principle is derived from the doctrine that it is equitable fraud in a third party knowingly to assist in a breach of trust, confidence, or contract by another.

We may also note two further cases suggesting that recipients of confidential information can be fixed with liability for dishonestly assisting in a breach of confidence: *Nanus Asia Co Inc v Standard Chartered Bank*,[139] a case from Hong Kong, and *Burger King Corp v Hungry Jack's Pty Ltd*,[140] a case from the New South Wales Court of Appeal.

If these cases are right,[141] then some of the classificatory questions we might want to ask are whether the equitable duty of confidence should properly be classified as a fiduciary duty, and whether claims for breach of confidence should properly be understood as claims in respect of misapplied property (which would suggest that the cases support the view that receipt of property may itself constitute assistance for the purposes of a dishonest assistance claim[142]). A negative answer to both of these questions was given not too long ago by the Supreme Court of Canada, in *Cadbury Schweppes Inc v FBI Foods Ltd*,[143] but although Binnie J's discussion of both issues was cogent and wide-ranging, his decision was in the end tied firmly to the facts of the case, and other answers have since been given.[144]

[138] R G Toulson and C M Phipps, *Confidentiality* (Sweet & Maxwell London 1996) 92. This formulation was itself derived by the authors from a passage of Lord Cottenham LC's speech in a famous old case, *Prince Albert v Strange* (1848) 1 Mac & G 25, 45, 41 ER 1171, 1179. *Sed quaere* whether equity will give an action for dishonest assistance in a breach of contract? For the view that it will not, see *Canadian Pacific (Bermuda) Ltd v Nederkoorn Pte Ltd* [1999] 2 SLR 18, 35–6 (per curiam): the *Royal Brunei* case "has absolutely no relevance here [as the] relationship between the appellants and the first respondents was purely contractual."

[139] [1990] 1 HKLR 396, 416–7 (Cruden DHCJ), holding that an insider trader had knowingly assisted in a breach of confidence by his source, the employee of a merchant bank, and that he held the profits of his wrongdoing on constructive trust for the merchant bank.

[140] NSWCA 21 June 2001, affirming *Hungry Jack's Pty Ltd v Burger King* [1999] NSWSC 1029. Cf *Sigma Chemicals (1986) Pty Ltd v Brown* [2001] WASC 39, paras 65–68 (Steytler J).

[141] Some support for the view that they are not can be gleaned from *Rodaro v Royal Bank of Canada* (Ontario Sup Ct 8 February 2000) paras 936–7 (Spence J), remarking that "in order to assert a claim of . . . knowing assistance in respect of a breach of fiduciary duty there must be such a duty . . . [yet a claim for breach of confidence] is at least as much in the nature of a tort as it is a breach of something like a trust or fiduciary obligation." However, Spence J found it unnecessary to decide whether a claim for dishonest assistance in a breach of confidence would lie, as "the plaintiffs' submissions [did] not invite the court to consider" this question.

[142] See the discussion in section (3)(d), below.

[143] [1999] 1 SCR 142, esp 164–5 and 168–173 (Binnie J), considering *LAC Minerals Ltd v International Corona Resources Ltd* [1989] 2 SCR 574.

[144] See eg, *A-G v Blake* [1998] Ch 439, 454 (per curiam), aff'd on a different point [2001] 1 AC 268; *Arklow Investments Ltd v Maclean* [2000] 1 WLR 595, 600 (per curiam); *Fyffes Group Ltd v Templeman* [2000] 2 Lloyd's Rep 643, 670 (Toulson J); *Walsh v Deloitte & Touche Inc* (PC 17 Dec 2001) paras 12–14 (per curiam).

Turning to our third question, whether liability for dishonest assistance can be incurred by those who assist in breaches of resulting or constructive trusts, we must first note that the courts do not always make it clear which of a resulting or constructive trust they have imposed.[145] This makes the task of analysing why such trusts are imposed no easier, but we need not investigate that difficult and controversial question here. For present purposes it is enough to note that liability for dishonest assistance clearly can be incurred by those who participate in breaches of either kind of trust,[146] and to note, too, that resulting and constructive trusts possess the common feature that "the consent of the trustee to act as such is not required."[147] The significance of this is that constructive and resulting trustees therefore most probably do not owe fiduciary duties to their beneficiaries, suggesting that the following cases give us a positive answer to our second question as well as our third.[148]

Where the legal owner of property passes it to another person by a mistake which is sufficiently fundamental to prevent the beneficial interest from passing to the recipient, a trust will be imposed on the property in his favour. This statement can be supported by reference to *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd*,[149] where Goulding J surprisingly held that a constructive (rather than a resulting) trust would be imposed in this situation.[150] Following the *Chase Manhattan* case, it has been held several times that a constructive trust of money mistakenly paid to another will be imposed by the courts in favour of the mistaken payor, and that a third party who subsequently assists

[145] See eg, *Collings v Lee* [2001] 2 All ER 332, 336 (Nourse LJ): "whether the trust should be characterised as implied, resulting or constructive is a matter of no importance."

[146] In addition to the cases which are discussed in the following text, see also *Aroso v Coutts & Co* [2002] 1 AII ER (Comm) 241, where an unsuccessful attempt was made to argue that the money in a bank account was held on resulting trust for the depositing account-holder, and that the defendant bank had dishonestly assisted in a breach of this resulting trust when it paid money out of the account to the order of the other account-holder. The claim failed, not because Lawrence Collins J thought it impossible for a defendant to incur liability for dishonestly assisting in a breach of a resulting trust, but because he considered that no resulting trust had ever arisen and that the claimant had failed to show that the defendant had acted dishonestly.

[147] L Smith "Constructive Fiduciaries?" in P Birks (ed), *Privacy and Loyalty* (Clarendon Press Oxford 1997) 249, 263.

[148] *Privacy and Loyalty* (n 147 above) 267, where Smith concludes his discussion of the question whether constructive and resulting trustees owe fiduciary duties to their beneficiaries with these words: "Long ago, when the only people who were made resulting or constructive trustees were people who had given a genuine undertaking to act in the interests of another, all trustees could be fiduciaries. [Citing *Keech v Sandford* (1726) Sel Cas T King 61, 25 ER 223 (constructive trustee) and *Ryall v Ryall* (1739) 1 Atk 29, 26 ER 39 (resulting trustee).] Now that resulting and constructive trusts are used more widely to get property to where equity thinks it belongs, the result must be different. . . . How does all this fit with the call for a rationalised law of accessory liability? If the trustee of a trust raised to reverse unjust enrichment owes no fiduciary obligations, can his dishonest agent be made liable for knowing assistance? Yes he can, because he is assisting in a breach of the bare obligation on that trustee to hold the property to the order of the beneficiary. In other words, one can be liable for assisting in a breach of trust even if that trust did not involve any fiduciary obligations."

[149] [1981] Ch 105.

[150] See too Lord Browne-Wilkinson's discussion of the *Chase Manhattan* case in *Westdeutsche Landesbank Girozentrale v Islington LBC* [1996] AC 669, 714–5.

the payee to misapply this money in breach of trust can be fixed with liability for dishonest assistance. Tuckey J considered this to be the law in *Bank Tejerat v Hong Kong and Shanghai Banking Corp (CI) Ltd*,[151] as did Cresswell J in *Bankgesellschaft Berlin AG v Makris*,[152] Mance LJ sitting as a first instance judge in *Grupo Torras SA v Al-Sabah (No 5)*,[153] and the Vanuatu Court of Appeal in *Barret v McCormack*.[154]

A trust may also be imposed where an unauthorized person purporting to act as the agent of a legal owner ostensibly binds him to an agreement with a third party under which his property passes to the third party, and the third party knows of the purported agent's lack of authority. A resulting trust analysis of this situation would focus on the legal owner's absence of consent to the transaction, but on some facts it might alternatively be argued that a wrong-based constructive trust is imposed here in the legal owner's favour. This situation was recently considered by the Court of Appeal in *Heinl v Jyske Bank (Gibraltar) Ltd*,[155] and their Lordships held on the authority of *Rolled Steel Products (Holdings) Ltd v British Steel Corporation*[156] that "where an agent is known by the other party to a purported contract to have no authority to bind his principal, no contract comes into existence" with the result that the purported contract cannot be effective to divest the principal of his beneficial interest in the property and to vest it in the third party. Hence, while legal title may pass to the third party when the property is transferred, it is unnecessary for the principal to rescind the transaction in order to regain a beneficial interest in the property, as a trust in favour of the principal arises in his favour at the moment when the third party gets the legal title: ie, equity treats the principal as the continuing beneficial owner of the property, no matter whether "the payment is dressed up . . . as an out and out payment, gratuitous or for consideration, as a loan, secured or unsecured and with or without interest."[157] The Court of Appeal also held in the *Heinl* case that where a third party receives a claimant's property in a transaction of this sort, and then disposes of it in breach of his duty to account for the property to the claimant, then a person who assists him in this breach of duty can incur liability for dishonest assistance if he does so with the relevant state of mind.

151 [1995] 1 Lloyd's Rep 239, 247.
152 QBD (Comm Ct) 22 January 1999.
153 QBD (Comm Ct) 24 June 1999; affirmed on a different point [2001] Lloyd's Rep Bank 36.
154 (1999) 4 ITELR 1.
155 [1999] Lloyd's Bank Rep 511, esp 519–521 (Nourse LJ).
156 [1986] Ch 246.
157 *Heinl v Jyske Bank* (n 155 above) 521 (Nourse LJ). This finding has since been reaffirmed in *Twinsectra Ltd v Yardley* [1999] Lloyd's Rep Bank 438, 461 (Potter LJ) and *Collings v Lee* [2001] 2 All ER 332, 337–8 (Nourse LJ). But cf *Greater Pacific Investments Pty Ltd (in liq) v Australian National Industries Ltd* (1996) 39 NSWLR 143, 153 (McLellan JA): "where there is a contract for the sale of property by A to B made in breach of a fiduciary duty owed by A to . . . C in whose breach B knowingly participated . . . the transaction is in equity voidable at the instance of A, who may (if necessary) obtain an order for rescission setting it aside. Unless and until A effectively avoids the transaction and (if necessary) obtains an order for rescission, B's property rights as a result of the transaction remain unaffected."

In *Gordon v Winnipeg Canoe Club*,[158] a case from the Manitoba Court of Appeal, the respondent was the owner of a tractor which he lent to a canoe club of which he was a member. The tractor was stolen, the club put in a successful claim for the loss under its insurance policy, and then paid the policy proceeds into its overdrawn bank account. The court held that the policy proceeds had been impressed with a constructive trust in the respondent's favour (on the ground of unjust enrichment) and that paying them to the club's bank had entailed a breach of this trust. The respondent sued the club officer responsible for "knowing assistance" in the club's breach of trust, but failed as the breach of trust had not been "fraudulent and dishonest" (as continues to be required under Canadian law[159]). We may note, though, that Huband JA could:[160]

> conceive of circumstances . . . where a defendant is held liable . . . [as a "knowing assistant"] for intermeddling with respect to a constructive trust based upon unjust enrichment or the like by virtue of the defendant's knowledge of a dishonest and fraudulent design.

Finally, the situation where a stranger simply steals a claimant's property was touched upon by Lord Browne-Wilkinson, in *Westdeutsche Landesbank Girozentrale v Islington LBC*, where he considered that the thief would be a constructive trustee of the property for the claimant, as "when property is obtained by fraud equity imposes a constructive trust on the fraudulent recipient."[161] In *Kuwait Oil Tanker Co SAK v Al Bader*,[162] Moore-Bick J then built upon this dictum to hold that "one who dishonestly participates in a theft, albeit as an accessory rather than a principal, must be liable along with the actual thief as constructive trustee." The idea that a thief who steals from a stranger commits a

[158] (1999) 172 DLR (4th) 423.
[159] See cases cited in n 171 below.
[160] *Gordon v Winnipeg Canoe Club* (n 158 above) 436.
[161] [1996] AC 669, 716. Some other recent cases have been concerned with the situation where money is stolen by an employee under a pre-existing fiduciary duty to the claimant, and a constructive trust of this money has been imposed in the employer's favour, with the result that the employer is prima facie entitled to sue third parties for dishonestly assisting in (or knowingly receiving money paid away in) a breach of this constructive trust. See *National Australia Bank Ltd v Rusu* [2001] NSWSC 32 (where the claims in dishonest assistance and knowing receipt were both unsuccessful); *Treaty Group Inc v Simpson* (2001) 103 ACWS (3d) 1072 (where the dishonest assistance claim failed and the knowing receipt claim succeeded); *Casio Computer Co Ltd v Sayo* [2001] EWCA Civ 661 (preliminary proceedings in a claim for dishonest assistance). Another case of this sort may also have been *Trustor AB v Smallbone* (CA 9 May 2000) esp paras 97–8 (Scott V-C), although in subsequent proceedings Morritt V-C seems to have understood the relevant part of the case to turn on the different question whether a company shareholder can be liable for knowing receipt where his company has received money paid in breach of trust or fiduciary duty: [2001] 1 WLR 1177. With respect, it does not seem that Morritt V-C quite grasped the point of Scott V-C's findings on the dishonest assistance point (cf comments above n 104); moreover, his analysis of the case as a corporate veil/knowing receipt-type case unfortunately does not take account of Ross Grantham's penetrating discussion in "Restitution and Insolvent Companies: Honing in on Shareholders" in F D Rose (ed) *Restitution and Insolvency* (LLP/Mansfield London, 2000) 220. Rimer J's decision at first instance in *Trustor AB v Smallbone* (Ch D 25 June 1999) was given in secret, and restrictions were placed on the publication of his judgment (an unsuccessful attempt to vary which restrictions was *Trustor AB v Smallbone* [2000] 1 All ER 811; application to appeal denied: CA 9 September 1999).
[162] QBD (Comm Ct) 17 December 1998.

breach of fiduciary duty if he then fails to account for the property to his victim looks suspiciously instrumental, a distortion of the fiduciary concept that runs counter to Sopinka J's salutary warning in *Norberg v Wynrib*,[163] that "equitable doctrines cannot be imported simply in order to improve the nature and extent of the remedy."

But even if Lord Browne-Wilkinson's proposition is a step too far, it seems that a collaborator in a theft might still be fixed with liability for dishonest assistance by another route. This brings us to our fourth and final question. For in *Grupo Torras SA v Al-Sabah (No 5)*,[164] Mance LJ (sitting as a judge at first instance) considered that:

> Insofar as [*Trustee of FC Jones & Sons (a firm) v Jones*[165]] suggests that a stranger C who abstracts a third party's (B's) monies may not breach any fiduciary duty, but may become liable simply at common law, it seems most improbable that this could mean that a third party D who dishonestly assisted C could escape liability for dishonest assistance. *Jones* was not concerned with this situation, and indeed recognised (in a different context) that it would be absurd if the position where a person had no title offered lesser protection at common law than would exist in equity where there was a bare legal title and constructive trust.

It is hard to know how to read this, since the nature of the liability incurred in *Jones* is a matter of controversy, and Mance LJ gives us no indication of his views on this point. He may think that dishonest assistance liability can be incurred by those who assist others to misappropriate property in circumstances which give rise to a personal claim in unjust enrichment to recover the value surviving in the defendant's hands; alternatively, he may think that it can attach to those who assist in misappropriations of property that give rise to a personal claim at common law to vindicate the claimant's property rights, analogous to the proprietary equitable claim recognized by the House of Lords in *Foskett v McKeown*.[166] Either way, Mance LJ's dictum marks a departure from previous case-law, as it suggests that liability for dishonest assistance may be incurred by those who assist others to misappropriate property in circumstances which give rise to a primary liability at common law, possibly even a primary liability at common law which is not founded upon a wrong.

### *(c) What Types of Breach?*

It often happens in practice that dishonest assistants collaborate with dishonest trustees or other fiduciaries, but the question arises, whether a defendant can be fixed with liability for dishonest assistance where the primary breach of duty was itself committed in good faith. As has been said already, the Privy Council

163 (1992) 92 DLR (4th) 449, 481.
164 QBD (Comm Ct) 24 June 1999; aff'd on a different point [2001] Lloyd's Rep Bank 36.
165 [1997] Ch 159.
166 [2001] 1 AC 102.

answered this question affirmatively in the *Royal Brunei* case,[167] and it seems unlikely that the English courts will decline to follow the Privy Council on this point even though the Court of Appeal previously held otherwise in *Barnes v Addy*[168] and *Belmont Finance Corp v Williams Furniture Ltd*.[169]

The Privy Council's decision on this point has also been accepted as good law by the New Zealand courts.[170] But it has not been followed in Canada, where the courts continue to insist that a dishonest breach of trust or fiduciary duty must have been committed, following the Supreme Court of Canada's decision to this effect in *Air Canada v M & L Travel Ltd*.[171] In Australia the position is unclear, as in some recent cases, the courts have drifted back towards the *Barnes v Addy* formulation that the primary breach must have been "fraudulent and dishonest."[172] However, the leading Australian case on accessory liability remains the High Court of Australia's decision in *Consul Developments Pty Ltd v DPC Estates Pty Ltd*,[173] where Stephen J referred to the requirement that an assistant must have known of "fraud or breach of trust,"[174] and where it was also said by McTiernan and Gibbs JJ that the primary breach need not have been fraudulent,[175] following Ungoed-Thomas J's findings to this effect in *Selangor United Rubber Co v Cradock (No 3)*.[176] Moreover, the rule in the *Royal Brunei* case was expressly followed by Finkelstein J in *Compaq Computer Australia Pty Ltd v Merry*,[177] while in *Turner v TR Nominees Pty Ltd*,[178] Santow J found it unnecessary to decide the point (as on the facts the trustee had been dishonest), but observed that:[179]

[167] Text to n 3 above.
[168] (1874) 9 Ch App 244.
[169] [1979] Ch 250, 267 (Buckley LJ), and 273–4 (Goff LJ); also *Belmont Finance Corp Ltd v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393, 405 (Buckley LJ) and 407 (Goff LJ).
[170] *Cigna Life Insurance (New Zealand) Ltd v Westpac Securities Ltd* [1996] 1 NZLR 80; *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 550 (Smellie J). Cf *Westpac Banking Corp v Savin* [1985] 2 NZLR 41, 70 (Sir Clifford Richmond); *Powell v Thompson* [1991] 1 NZLR 597, 613 (Thomas J).
[171] [1993] 3 SCR 787, 813–826 (Iacobucci J), followed on this point in many cases, for example: *Gold v Rosenberg* (1995) 25 OR (2d) 601, 604–5 (Laskin JA), aff'd [1997] 3 SCR 767, 782 (Iacobucci J); *Citadel General Assurance Co v Lloyd's Bank Canada* [1997] 3 SCR 805, 819 (La Forest J); *Gordon v Winnipeg Canoe Club* (1999) 172 DLR (4th) 423, 437 (Huband JA); *Burton v Global Benefit Plan Consultants Inc* (1999) 178 Nfld & PEIR 169, 173 (Orsborn J); *Northland Bank v Willson* (1999) 249 AR 201, 223 (Wilkins J); *Sorrel 1985 Limited Partnership v Sorrel Resources Ltd* [2001] 1 WWR 93, 107 (Picard JA); *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 249 (Huband JA).
[172] *Lyford v Commonwealth Bank of Australia* (1995) 13 ACLC 900, 914 (R D Nicholson J); *National Mutual Property Services (Australia) Pty Ltd v Citibank Savings Ltd* (Fed Ct of Aus 25 May 1998); *Gertsch v Atsas* [1999] NSWSC 898.
[173] (1975) 132 CLR 373.
[174] *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (n 173 above), 412.
[175] *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (n 173 above), 386 (McTiernan J) and 398 (Gibbs J).
[176] [1968] 1 WLR 1555, 1582 and 1590, rejected in England by the Court of Appeal in the *Belmont Finance* case (n 5 above).
[177] (1998) 157 ALR 1, 5–6.
[178] (1995) 31 ATR 578.
[179] *Turner v TR Nominees Pty Ltd* (n 178 above), 591–2.

Lord Nicholls formulated a new accessory liability principle which meets the criticism of Lord Selborne's formulation, made by Kirby P in *Equiticorp Finance Ltd (in liq) v Bank of New Zealand*.[180] Kirby P remarked that he could "see no reason why, to render a bank, the recipient of trust funds, liable to account, it should be shown that the breach occurred in furtherance of a 'dishonest and fraudulent design' involving the Bank of New Zealand".

## 3 Assistance

There are of course as many ways to facilitate the commission of a primary breach as the human imagination can contrive. In practice, though, claims in dishonest assistance have most often been brought in the past few decades against financial and legal professionals and organizations: accountants, banks, company directors, solicitors, and so on. No doubt this reflects the fact that their expertise and/or position is such that many financial frauds cannot be perpetrated without their help. No doubt, too, their amenability to the court's jurisdiction and their deep pockets make it worth suing them.

Claims in dishonest assistance against company directors raise special issues, which are discussed below in sub-section (c). So do claims in dishonest assistance against banks which have received misapplied funds, discussed below in sub-section (d). A typical example of an (unsuccessful) action against a bank which has paid funds out of a customer's account is *Lipkin Gorman v Karpnale Ltd*,[181] where a partner withdrew funds from the firm's account in breach of the fiduciary duty which he owed to his fellow partners, and where the point was made in the Court of Appeal that claims of this kind are rare, because it is generally easier for the customer to prove a breach of the bank's contractual duty of care to the customer than to prove dishonesty on the part of the bank officials involved in making the payment.[182] A typical example of a claim against a solicitor is

[180] (1993) 32 NSWLR 50, 105.

[181] [1989] 1 WLR 1340, not considered on appeal: [1991] 2 AC 548. See too *Aroso v Coutts & Co* [2002] 1 All ER (Comm) 241, where it was unsuccessfully argued that money deposited with the bank was held on resulting trust for the claimant, and that the bank dishonestly assisted in a breach of this trust when it paid money out of the account to the order of one of the account-holders.

[182] *Lipkin Gorman v Karpnate Ltd* (n 181 above), 1376–8 (Parker LJ). See too *Barclays Bank plc v Quincecare Ltd* [1988] 1 FTLR 507, 516–7 (Steyn J), noting that the bank's duties in contract and tort would be co-extensive in this situation. Australian cases confirming that banks owe a duty of care to their customers in contract and/or tort when processing orders to make payments on their behalf are: *Ryan v Bank of NSW* [1978] VR 555, 578–82 (McGarvie J); *Varker v Commercial Banking Co of Sydney* [1972] 2 NSWLR 967, 975–9 (Macfarlan J). The point was also conceded by the appellant bank in *National Australia Bank Ltd v Gordon* (Victoria CA 11 April 1996). However, Steyn J's remarks were considered by the NSWCA, in *Sansom v Westpac Banking Corp* (1996) Aust Tort Reps 81–383, and at 63,328, Sheller JA observed that if they were right, then "Westpac owes a greater duty in tort than as a fiduciary," and concluded that the content of the two duties is the same, with the result that a bank which has no knowledge of circumstances sufficient to put it on enquiry does not breach its common law duty to its customer. Powell JA agreed in the result without rejecting the possibility that a bank's common law duties might go beyond its duties in equity.

*Dubai Aluminium Co Ltd v Salaam*,[183] in which a solicitor settled an action for dishonest assistance founded on the assertion that among other things he had drafted sham legal documents designed to facilitate or disguise the fraudulent transfer of the claimant company's property to third parties. A typical example of a claim against an accountant is *Lurgi (Aust) Pty Ltd v Ritzer Gallagher Morgan Pty Ltd*,[184] in which the defendant accountant was found liable for dishonest assistance where he had enabled a pair of fraudulent company directors to steal money from the company by manufacturing a series of sham invoices, preparing the books of shell companies through which the claimant company's funds were laundered, and handling the shell companies' bank accounts.

### *(a) Causative Impact*

For a defendant to have assisted in a primary breach of duty in a relevant way, his actions or omissions[185] must have helped the primary wrongdoer: he cannot relevantly have assisted in a primary breach if his actions or omissions have either hampered the primary wrongdoer or been of "minimal importance" to him.[186] There is no need for the claimant to show that the dishonest assistant's action "inevitably [had] the consequence that a loss [was suffered],"[187] nor is it an answer to a claim that a dishonest assistant "only participated in a part of a chain of events all of which led to [the primary breach], or to assert that the [primary breach] would probably have occurred without his assistance."[188] But although it is "inappropriate" for the court "to become involved in attempts to assess the precise causative significance of the dishonest assistance in respect of . . . the breach of trust or fiduciary duty,"[189] a claimant must show that the defendant's actions or omissions has had *some* causative significance, for "if there is no causative effect and therefore no assistance given by the [defendant] . . . the requirements of conscience [do not] require any remedy at all."[190]

[183] [2001] QB 113. See too *Bank of New South Wales v Adams* [1982] 2 NSWLR 659; *Equiticorp Group Ltd v Hawkins* [1991] 3 NZLR 700; *Beach Petroleum NL v Abbott Tout Russell Kennedy* (1999) 48 NSWLR 1; *Twinsectra Ltd v Yardley* [1999] Lloyd's Bank Rep 438, 462–6 (Potter LJ).

[184] [2000] VSC 277. See too *Agip (Africa) Ltd v Jackson* [1990] Ch 265, aff'd [1991] Ch 547; *Springfield Acres Ltd (in liq) v Abacus (Hong Kong) Ltd* [1994] 3 NZLR 502; *News International plc v Clinger* (Ch D 17 November 1998) paras 380–388 (Lindsay J); *Barret v McCormack* (1999) 4 ITELR 1; *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734.

[185] Omissions present special problems which are considered in sub-section (b) below.

[186] *Baden, Delvaux* (n 8 above) 574 (Peter Gibson J).

[187] *Baden, Delvaux* (n 8 above) 575 (Peter Gibson J).

[188] *Balfron Trustees Ltd v Peterson* (2001) 151 NLJ 1180, transcript para 21 (Laddie J), noting that a dishonest assistant's liability arises from "the fact of assistance to the primary wrongdoers," and "not because he [carries] out all, or even the majority of the acts which [constitute] the primary breach."

[189] *Grupo Torras SA v Al-Sabah (No 5)* (QBD (Comm Ct) 24 June 1999) (Mance LJ, sitting as a judge at first instance); aff'd on this point [2001] Lloyd's Rep Bank 36, 61 (per curiam), and again in *Casio Computer Co Ltd v Sayo* [2001] EWCA Civ 661, paras 15 (Tuckey LJ) and 52 (Pill LJ). *Sed quaere* whether Tuckey and Pill LJJ can have been correct in the latter case to suggest that a claimant need prove no causal link at all between a dishonest assistant's actions and the claimant's loss?

[190] *Brown v Bennett* [1999] 1 BCLC 649, 659 (Morritt LJ).

It follows that although a defendant might incur liability for actions or omissions which precede the commission of a primary breach,[191] he cannot be liable if his actions or omissions have only occurred after the primary breach of trust has been fully implemented.[192] If the primary wrongdoer has committed a series of breaches, the defendant can only be liable in respect of those to the commission of which his actions or omissions have made a difference.[193] And it does not suffice to fix a defendant with liability that he has merely enjoyed a personal advantage deriving from the primary breach if he has not solicited this breach or assisted in its implementation.[194]

On the other hand, a defendant can be liable for dishonest assistance where he has actively enabled a wrongdoing fiduciary to derive some personal advantage from a primary breach of duty. So, Giles J held in an Australian case, *BTR Engineering (Australia) Ltd v Patterson*, that:[195]

> Benefit to the fiduciary will often be an element in his breach, but even if that is not so the fiduciary may have breached his duty in order to obtain the benefit. . . . There is no reason to limit equity's extension of responsibility by ignoring reality, and the reality is

[191] R P Austin "Constructive Trusts" in P D Finn (ed) *Essays in Equity* (Law Book Co Sydney 1985) 196, 237–8, discussing *Adams v Bank of New South Wales* [1984] 1 NSWLR 285: "It would be too rigid to say that a third party who assists in a breach of trust which, at the time of the assistance, is merely apprehended, is never liable. But *Adams* demonstrates that the grounds of apprehension must be strong . . ." For assistance of this sort, see eg, *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corp Ltd)* [2001] NSWSC 14: a company director promoted a plan for the expansion of the company's business through a joint venture which entailed appointing the company's advisers to directorships of target companies; this plan was "structurally deficient" because it led to the advisers being placed in a position of "inevitable, irretrievable" conflict of interest; the director had accordingly assisted in the advisers' breaches of fiduciary duty, although on the facts he had not been dishonest (a finding which is queried below at n 285).

[192] As in eg, *Brown v Bennett* [1998] 2 BCLC 97, 105 (Rattee J, affirmed on this point on appeal): "The breach and the resultant damage to the company were complete before Oasis came on the scene."

[193] *Grupo Torras SA v Al-Sabah (No 5)* (QBD (Comm Ct) 24 June 1999) (Mance LJ, sitting as a judge at first instance): "it is necessary to identify what breach of trust or duty was assisted and what loss may be said to have resulted from that breach of trust or duty. An allegation of a single and continuing conspiracy to commit and cover up a misappropriation is one thing. But it may involve a series of breaches of trust or fiduciary duty. The actual loss may have resulted at the early stage of the misappropriation, rather than from the cover up. Dishonest assistance confined to the cover up stage may or may not necessarily attract liability for such a previous loss."

[194] Cf *BTR Engineering (Australia) Ltd v Patterson* (NSW Sup Ct (Comm Div) 20 June 1991) (Giles J): "to have the benefit of the discharge of [a loan] . . . for which [the defendant] apparently had a secondary liability as a guarantor would not seem to me to be assistance of the kind required." See too *Satnam Investments Ltd v Dunlop Heywood & Co Ltd* [1999] 1 BCLC 385, 390 (Nourse LJ), stressing that the defendant company, Morbaine, had not solicited the letter which it had received from another defendant in breach of fiduciary duty, and which had contained information which Morbaine had then turned to its advantage. At 403, he also states that "although [the trial judge] referred to 'the breach of fiduciary duty to which [Morbaine] was knowingly party', we cannot treat that as a finding that Morbaine participated in the breaches," and that "it is necessary to emphasise that Morbaine did not participate in [the other defendants'] breaches of their fiduciary duties to [the claimant]." In the light of these statements it is hard to know what to make of his further observation at 404, that "we would not have wanted to shut out the possibility of [a claim in dishonest assistance] . . . being successful if the judge had made a finding of dishonesty against Morbaine."

[195] NSW Sup Ct (Comm Div) 20 June 1991.

that obtaining the benefit—getting it into his hands or having it applied as he wishes—will normally be essential to the defaulting fiduciary. That is why he breaches his duty. That is part of his design, and a stranger who assists with knowledge in that part of the design may be liable accordingly.

Similarly, in *Heinl v Jyske Bank (Gibraltar) Ltd*,[196] Nourse LJ held that a breach of trust which entails the misapplication of funds is not fully implemented until the funds have been hidden away where the beneficiaries cannot find them, with the result that those who assist in money-laundering activities after the funds in question have been removed from the trust account can be liable for dishonest assistance. However, we may compare these findings with Mance LJ's finding at first instance in *Grupo Torras SA v Al-Sabah (No 5)*,[197] that one of the defendants, a company director named Soler, had not dishonestly assisted in the misappropriation of company funds where he had helped to cover up the company's losses by giving misleading information to the auditors and presenting misleading accounts to the shareholders. In His Lordship's words:

No case is made that, but for such conduct by Mr Soler, monies would have been recovered which are now lost, or even that, but for such conduct, subsequent misappropriations would not have occurred. In these circumstances, reprehensible though Mr Soler's conduct was, I do not consider that it attracts accessory liability . . .

These findings were not considered on appeal.[198] With respect to Mance LJ, they are hard to reconcile with the decisions already mentioned, and they also appear to be inconsistent with the principle that a claimant need only show that a dishonest assistant's actions have had some causative significance for the implementation of the primary breach.

### *(b) Omissions*

In the *Royal Brunei* case, Lord Nicholls considered that "honesty and its counterpart dishonesty are mostly concerned with advertent conduct."[199] Consistently with this observation, the courts in recent cases have tended to hold that a defendant must have undertaken some positive action before he can be fixed with liability as a dishonest assistant. In other words, the courts have generally been reluctant to fix defendants with liability on the basis that they have passively

[196] [1999] Lloyd's Rep Bank 511, 523 (Nourse LJ), approving *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 293 (Millett J). Cf *Donnelly v Gibson Sheat Nominees Ltd* (NZ High Ct 13 December 1993), where Heron J held that a person can assist in a breach of trust when the trustees' breach predates his assistance, provided that the assistance "is material assistance in the sense that it contributes to the loss"; *Casio Computer Co Ltd v Sayo* [2001] EWCA Civ 661, para 22 (Tuckey LJ), doubting Anthony Mann QC's finding at first instance that the "damage to [the claimant] only occurred when the money was abstracted from [its] bank account," and suggesting that "there must be a strong argument for saying that damage was also caused" when the money was withdrawn from the wrongdoing fiduciary's own account and transferred elsewhere.

[197] QBD (Comm Ct) 24 June 1999.

[198] [2001] Lloyd's Rep Bank 36.

[199] *Royal Brunei* (n 1 above) 389.

acquiesced in another person's activities.[200] The courts may be criticized for this tendency, to the extent that it reflects a failure to recognize that an omission can have as great a causative impact as a positive action in some circumstances. However, it must be borne in mind that hypothetical inquiries into whether an honest person in a particular position would have acted in a particular way are notoriously difficult,[201] and so too are calculating the probable consequences of such actions and the further actions which an honest person would then have undertaken in response to these consequences.[202] To the extent that it reflects a proper understanding of these difficulties, the courts' approach therefore seems defensible, although it might clarify matters if they were to state expressly what is implicit in many of their decisions on this point, that to make out the "*actus reus*" of assistance a claimant must show that the act or omission complained of has enabled the commission of the primary breach in some way.

The clearest judicial expression of these concerns is to be found in *Beach Petroleum NL v Abbott Tout Russell Kennedy*,[203] a decision of the New South Wales Court of Appeal. Here, the court held that the structure of the appellant company's submissions was "fundamentally flawed," where it had adopted a two-stage approach that entailed establishing the knowledge possessed by the respondent solicitors, and then asserting what positive steps an honest person possessed of such knowledge would have taken in the same circumstances. In the court's view, this approach was an unsatisfactory method of establishing that the solicitors' inactivity had been dishonest, as it had "operate[d] on the assumption that given a certain state of knowledge . . . there is only one thing an honest person will do," yet "nothing in the circumstances of this case suggest[ed] that such a conclusion was open by way of reasonable, let alone necessary inference." Moreover, the appellant had failed "to identify any one or other of the steps said to have been required by an honest person, as more important than any other" and so had effectively "invite[d] the court to enter a bewildering number of alternate inquiries as to causation."

Other cases on this issue include *Brinks Ltd v Abu-Saleh (No 3)*,[204] in which Rimer J held that the proceeds of a gold bullion robbery could be characterized

[200] In addition to the cases which are discussed in the following text, see *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 664–7, esp 667 (Smellie J): "I do not go so far as to hold that acquiescence can never amount to assistance. There may be circumstances where it will, although they are difficult to envisage."

[201] Cf H L A Hart and T Honoré *Causation in the Law* (2nd edn OUP Oxford 1985) 412: "If the defendant could have complied with the law in more than one way, should it be assumed that he would have complied with it in the cheapest way, to the minimum extent, or in the most effective way?"

[202] *Causation in the Law* (n 201 above), 413: "When human reactions are in question a difficulty often arises from the fact that we can seldom say with assurance how a person would have reacted to a situation which did not in fact occur"; and 417: "It is more difficult to prove a connection which depends on several hypothetical contingencies than one which depends on few."

[203] (1999) 48 NSWLR 1, 87–9 (per curiam).

[204] The Times 23 October 1995. See too *Nightingale Finance Ltd v Scott* (Ch D 18 November 1997) where Carnwath J held that "for a third party to become liable as a 'knowing assistant' he must be an active participant in the breach of trust," and that a third party who incidentally removes

as trust money because they had been misappropriated from the claimant in breach of a fiduciary duty which had been owed to it by one of the robbers, a security guard in the claimant's employment who had provided his fellow conspirators with a key to the claimant's warehouse and information about its security arrangements. However, Rimer J refused to hold that the defendant had assisted in a breach of trust when she had accompanied her husband on trips to Switzerland, where he had laundered the proceeds of the robbery by depositing large sums of cash with a Swiss bank. In effect, Rimer J absolved her from liability on the ground that she had passively acquiesced in her husband's activities. This may have been a generous interpretation of her behaviour, given that she had actively accompanied him on his trips and in so doing had lent authenticity to the cover story he had offered to Swiss customs officials, that the pair were antique dealers entering Switzerland on business.

In a Canadian case, *Treaty Group Inc v Simpson*,[205] Pardu J declined to hold that the defendant had assisted in his wife's embezzlement of money from her employer when he failed to report her activities to the employer. And in another Canadian case, *Bare Land Condominium Plan 8820814 v Birchwood Village Greens Ltd*,[206] Nation J held that a company director was liable for knowingly assisting in the company's breaches of a statutory trust where he has been "the guiding force" in the company, but declined to hold that two other directors were similarly liable, where they had taken no active part in the transactions complained of. This finding sits rather uneasily alongside some other recent cases on company directors in which it has been held that they owe positive duties to monitor one another's activities and play an active role in the supervision of the company's affairs.[207]

Finally, in his first instance decision in *Goose v Wilson Sandford & Co (No 2)*,[208] Rimer J held that a firm of partners could not be liable for dishonest assistance on the ground that they had failed to prevent their client, a fiduciary, from making misrepresentations to his principal. Rimer J also made the slightly different point in this case, that he did "not understand how A can assist B not to disclose something," save by making representations which lent authenticity to

obstacles in a wrongdoing fiduciary's path while acting in his own interest cannot be liable as an accessory to the fiduciary's breach, even if he possesses the requisite state of mind for liability.

[205] (2001) 103 ACWS (3d) 1072, para 15 (the defendant was in any case liable to his wife's employer for knowing receipt). Cf *Banque Nationale de Paris v Hew* [2001] 1 SLR 300, 336–8 (Lai Kew Chai J), where the judge unfortunately leaves it unclear whether the defendants assisted in the primary wrongdoer's breaches of fiduciary duty when they failed to report their knowledge of his unauthorized foreign exchange dealings to his employer. And cf *Lurgi (Australia) Pty Ltd v Gratz* [2000] VSC 278, paras 59–69, where Byrne J accepted that the primary wrongdoer's wife had assisted his breaches of duty to his employer, but did not accept that she had done so dishonestly.

[206] Alberta QB 30 November 1998, paras 67–70 (Nation J). See too *Hub City Supplies v Total Drywall Ltd* (British Columbia Sup Ct 16 Sept 1996) para 17 (Dillon J), finding that a director had not assisted in a company's primary breach because "she played no part in the business decisions of the company and handled minor clerical tasks".

[207] See eg, *Re Barings plc (No 5)* [2000] 1 BCLC 523, esp 535–6 (per curiam), affirming Jonathan Parker J at first instance: [1999] 1 BCLC 433, 483–9.

[208] Ch D 25 January 1999.

B's silence—and in such a case, he considered that the complaint against the fiduciary should properly be cast as a claim in conspiracy or deceit, rather than a claim in dishonest assistance. With respect, though, the better view is surely that a third party assists in a breach of fiduciary duty if he makes positive representations to a principal which enable the fiduciary to breach his duty by failing to disclose matters which he ought to disclose. On appeal, the Court of Appeal affirmed Rimer J's decision that no liability had been incurred by the defendant on the different basis that the defendant's representations to the claimant had not been made in connection with any breach of fiduciary duty by his dishonest client. Their Lordships therefore found it unnecessary to address the question whether Rimer J had been right to say that these representations could not have amounted to assistance in themselves.[209] In this connection, however, we may note Patten J's recent decision in *Fayers Legal Services Ltd v Day*.[210] Here, a financial consultant had actively participated in the management of a company, and had thereby helped to maintain the appearance that it was being run as a legitimate business. Patten J held that by doing these things the consultant had relevantly assisted the breaches of fiduciary duty committed by the company's main director, who had systematically misappropriated the company's assets over several years, and who had disguised this fact from the shareholders by making a series of misrepresentations to them.

### *(c) Principals and agents*

A principal whose agent commits a breach of duty to a claimant can be made vicariously liable for the agent's wrong, even if the agent acts dishonestly with a view to enriching himself, if the principal has actually or apparently authorized him to perform the impugned actions in the course of carrying on the principal's business.[211] On occasion, though, it has been argued that a principal should be liable for his agent's breach of duty for a different reason, namely that the principal has committed the wrong of dishonest assistance by empowering the agent to act. Arguments of this sort have not fared particularly well in the courts, perhaps because the "empowerment" which has been alleged to constitute assistance in the relevant cases has been of a fairly tangential kind.

Thus, it has been argued that the shareholders of a company "authorize" the company to act by supplying it with the financial means to do so, and thereby assist in its breaches of duty to third parties. But in response the courts have made it clear that "capitalist control" of this sort is not enough to fix shareholders with liability as assistants, and that something closer to "functional control" is required—ie, the shareholder of a company cannot be said to have assisted in breaches of duty owed by the company to third parties unless the directors cause

209 CA 14 March 2000.

210 Ch D 11 April 2001, para 75.

211 *Armagas Ltd v Mundogas SA* [1986] AC 717, 781–3 (Lord Keith); *Alliance and Leicester BS v Edgestop* [1994] 2 EGLR 229, 251 (Mummery J).

the company to act in breach of duty on the shareholder's express instructions (alternatively, of course, the shareholder may be a director of the company himself).

So, for example, in *Springfield Acres Ltd (in liq) v Abacus (Hong Kong) Ltd*,[212] where the director of a company had dishonestly caused it to receive the misappropriated funds of a second company and to pay these over to third parties, Henry J held in the New Zealand High Court that "the fact of [the defendants'] ownership of [the first company] is not sufficient of itself to make [the defendants] responsible for the actions of the company." Likewise, in a Canadian case, *Transamerica Life Insurance Co of Canada v Canada Life Assurance Co*,[213] Sharpe J held that "without proof of knowing involvement in the breach of trust, the law does not impose equitable liability simply on the basis that the targeted defendant is the owner of the corporate entity which committed the equitable wrong."

A related question, to which a similar answer was given, arose in an Australian case, *Tableau Holdings Pty Ltd v Joyce*.[214] Here, a director and shareholder of the appellant company committed breaches of fiduciary duty owed to a third party, from which the company stood to benefit indirectly. The third party sued the company for dishonest assistance. The director and his brother were the company's only directors, and they and their wives were its only shareholders. The third party argued that these facts led inexorably to the inference that the director's actions had been authorized by the company, with the result that it had relevantly assisted in his breaches. However, the court rejected this contention and stated that something more would be required before the company could be said to have assisted in the director's wrongdoing. Speaking for the court, Steytler J also held that it did not follow from the fact that the company had indirectly benefited from the breaches of duty that it had assisted in them.[215]

Looking at the relationship between a principal and his agent from the other end, we may see that agents are very often held liable for assisting in their principals' breaches of equitable duty, especially when we look at cases concerning company directors. In the *Royal Brunei* case itself, the respondent managing director conceded that he had "assisted" his company to commit a breach of trust when he caused it to misapply trust funds belonging to the appellant—and many other authorities also show that company directors whose companies have committed a primary breach may be personally liable for dishonest assistance if they have caused their companies to engage in the relevant transaction.[216] A question

[212] [1994] 3 NZLR 502, 512.
[213] (1996) 62 ACWS (3d) 891. Subsequent proceedings: (1998) 22 ETR (2d) 106; reversed in part: Ontario CA 9 April 1999.
[214] WA Sup Ct 14 June 1999.
[215] Cf the text to nn 233 and 234 below.
[216] See eg, *Scott and Scott v Riehl and Schumak* (1958) 15 DLR (2d) 67, 73–4 (Wilson J); *Watson v Dolmark Industries Ltd* [1992] 3 NZLR 311, 316 (Cooke P) and 319 (Gault J); *Air Canada v M &*

arises in relation to these cases on company directors, however, which is prompted by the Court of Appeal's recent decision in *Standard Chartered Bank v Pakistan National Shipping Corp (No 2)*.[217]

To explain this, it must first be observed that the English courts have developed two distinct theories of how companies act. The position generally taken is that a company can act only through human individuals who have been actually or apparently authorized to act on its behalf,[218] and that agency rules and the doctrine of vicarious liability should be used to determine whether the company is bound by, or responsible for, the acts of any given human individual. These rules were referred to by Lord Hoffmann in *Meridian Global Funds Management Asia Ltd v Securities Commission* as the "primary rules of attribution."[219] They are consistent with the view that an individual who has acted as a company's agent may himself be fixed with personal liability in tort, for example, in respect of his actions towards third parties, even though these actions were committed during the course of his employment by the company and within the scope of his authority, and even though the company is itself therefore vicariously liable in respect of the same wrong.

Confusingly, however, the English courts have also held that in some circumstances it is appropriate to view a company as acting through a human individual with whom it may be "identified," with the consequence that his state of mind is deemed to be the company's state of mind, because he "is" the company at the time of his actions. This theory was referred to by Lord Hoffmann in the *Meridian* case as a "special" rule of attribution,[220] and we shall return to it below when we come to consider whether artificial persons can ever act dishonestly.[221] For now, though, the point to note is that it does not necessarily follow from the fact that the "identification doctrine" can be used to fix a company with liability for an individual's actions that this person cannot also be personally liable for

*L Travel Ltd* [1993] 3 SCR 787, esp 827–8 (Iacobucci J); *Turner v TR Nominees Pty Ltd* (1995) 31 ATR 578; *HR v JAPT* (1998/1999) 2 OFLR 252, 284 (Lindsay J); *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 252–3 (Huband JA); *Bare Land Condominium Plan 8820814 v Birchwood Village Greens Ltd* (Alberta QB 30 November 1998) paras 57–73 (Nation J); *Van Vliet Construction 1988 Ltd v Jaeger* (British Columbia Sup Ct 9 Jan 1998); *Botterill v Schuringa* (Out CA 10 Dec 1998).

See too *Australian Securities Commission v AS Nominees Pty Ltd* (1995) 18 ACSR 459, 476 (Finn J), observing that liability for knowing assistance is "of no little significance to the directors of a trust company for the very reason that, often enough, it will be their own conduct in exercising the powers of the board which causes their company to commit a breach of trust." And see too *Casio Computer Co Ltd v Sayo* The Times 6 February 2001, para 16 (Anthony Mann QC, sitting as a deputy High Court judge), aff'd on another point [2001] EWCA Civ 661: a director can be liable for dishonest assistance where he has caused his company to receive funds in breach of trust and so incur liability for knowing receipt.

[217] [2000] 1 All ER (Comm) 1.

[218] See eg, *Freeman and Lockyer (a firm) v Buckhurst Park Properties Ltd* [1964] 2 QB 480; *British Bank of the Middle East v Sun Life Assurance Co of Canada (UK) Ltd* [1983] 2 Lloyd's Rep 9; *First Energy (UK) Ltd v Hungarian International Bank Ltd* [1993] 2 Lloyd's Rep 194.

[219] [1995] 2 AC 500, 507.

[220] *Meridian Global Funds Management Asia Ltd v Securities Commission* (n 219 above) 507.

[221] See section (4)(f) below.

them himself.[222] But still, this conclusion was recently drawn by Evans LJ, in the *Standard Chartered Bank* case, where he considered that to hold otherwise would threaten the "pre-eminence" of the company's separate legal personality, and accordingly held that a company director who had made a fraudulent misrepresentation to the claimant in the course of his employment could not be held personally liable for the tort of deceit.[223]

Evans LJ's analysis was strongly influenced by Ross Grantham's argument that the language of artificial personality used by the courts to describe certain groups of human associates amounts to nothing more than a convenient metaphorical shorthand for the conclusion that it is appropriate to modify or disapply the substantive rules of law which would normally apply to the associates as natural persons.[224] However, some care is needed when handling this insight. It can be very helpful to understand the language of artificial personality as shorthand for the conclusion that it is appropriate *in certain situations* to modify or disapply the substantive rules of English law as they would otherwise affect the associates. For this should make it clear that the question whether the substantive rules should be modified or disapplied is a policy issue which should be expressly considered on a case-by-case basis. But Evans LJ's statement that the separate legal personality of a company must be given "pre-eminence" creates the risk that the need for such a policy discussion will be overlooked in future cases, if his words are taken to mean that the substantive rules must automatically be modified or disapplied *in every situation* involving a group of natural persons which has been said to possess artificial personality.

This is essentially the point made by Potter LJ, when he came to consider Evans LJ's analysis in *SX Holdings Ltd v Synchronet Ltd*,[225] and reached the opposite

[222] A point well made in J Armour "Corporate Personality and Assumption of Responsibility" [1999] LMCLQ 246.

[223] *Standard Chartered Bank* (n 217 above) 20, glossing the House of Lords' decision in *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830. See too Hirst LJ's judgment in the *Williams* case in the Court of Appeal, [1996] 1 BCLC 131, 148, approving *Trevor Ivory Ltd v Anderson* [1992] 2 NZLR 517, 527 (Hardie Boys J). And cf *Harman v Tappenden* (1801) 1 East 555, 102 ER 214, cited in *Mill v Hawker* (1874) LR 9 Ex 309, 321–2 (Kelly CB) (dissenting), in support of the following statement: "I conceive it to be settled law that no action lies against the individual members of a corporation for a corporate act done by the corporation in its corporate capacity unless the act be maliciously done by the individuals charged and the corporate name be used as a mere colour for the malicious act." Piggot and Cleasby BB did not address this point as they thought the actions in question were ultra vires, nor was it considered on appeal: (1875) LR 10 Ex 92.

[224] This theme is explored in R Grantham "Restitution and Insolvent Companies: Honing in on Shareholders" in F D Rose (ed) *Restitution and Insolvency* (LLP Ltd London 2000) 220. See also R Grantham and C Rickett "Directors' Tortious Liability: Contract, Tort, or Company Law?" (1999) 62 MLR 133.

[225] CA 10 October 2000, paras 23–5. Cf *Noel v Poland* (QBD (Comm Ct) 14 June 2001), where Toulson J declined to give summary judgment against a company director in relation to fraudulent misrepresentation on the basis of legal submissions founded on the *Standard Chartered Bank* case. Drawing on arguments set out in P Watts "The Company's Alter Ego—An Impostor in Private Law" (2000) 116 LQR 525, Toulson J considered that the CA's reasoning in the *Standard Chartered Bank* case is irreconcilable with previous authorities, including decisions of the HL, in which claims in deceit against directors have been treated no differently from claims in deceit against other agents,

conclusion, that a company director could be held liable for fraudulent misrepresentations made in his capacity as director. Potter LJ's discussion merits careful study, as much for the manner of his approach as for his conclusion:

> in cases of fraud and deceit, it is by no means easy to see as a matter of policy or logic why the hegemony to be accorded to the principle of company law concerning the separate personality of companies should lead to a "let-out" of this kind for an individual who knowingly defrauds another in the name of a company in which he is interested, for his own financial benefit. Whereas liability for negligence is a liability imposed in respect of inadvertent damage caused to one's "neighbour" and/or upon the postulate that the defendant has deliberately assumed a personal responsibility to the injured claimant, liability in deceit is imposed on the basis of harm deliberately (or recklessly) caused by a representor to a "targeted" representee. . . . [In] another context, Lord Steyn has made clear the strength of the rationale, in terms of deterrence and morality, which underlies the imposition of wider personal liability upon a defendant who is an intentional wrongdoer than that which is imposed upon one less blameworthy in the sliding scale of civil damages . . .[226] Thus there is much to be said for the view that there are strong countervailing reasons of policy why personal liability should not be avoided simply on the basis that the representation was purportedly made, and understood to be made, in the representor's capacity as a company director, particularly when he is the controlling shareholder and moving spirit in relation to that company, use of whose name is adopted as part and parcel of his own fraudulent scheme.

According to circumstances, then, it *may* be appropriate to absolve a company director from personal liability for dishonest assistance where he has caused the company to commit a primary breach or to assist in it or to receive misdirected funds. But before a court reaches such a conclusion, it must first examine the underlying purpose of dishonest assistance liability and its interaction with the rules of company law, and in the light of Potter LJ's foregoing discussion, a court may well feel that in the interests of both deterrence and morality, liability should be imposed.

Unfortunately no such analysis of the relevant policy issues was undertaken in a New Zealand case where a director was absolved of such liability in respect of certain actions undertaken in his official capacity, *Springfield Acres Ltd (in liq) v Abacus (Hong Kong) Ltd*,[227] leaving us to guess what the judge might have thought about these matters had he turned his mind to them. However, it does seem from dicta in an Australian case, *Wickstead v Browne*,[228] that directors are

and in which the argument based on the "identification doctrine" has formed no part of the courts' reasoning. See too *Merrett v Babb* [2001] QB 1065, where May LJ disagreed with Aldous LJ's analysis of a similar issue (which was itself in line with Aldous LJ's previous agreement with Evans LJ in the *Standard Chartered Bank* case).

226 Citing *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254, 279.

227 [1994] 3 NZLR 502, 512 (Henry J).

228 (1992) 30 NSWLR 1. Cf *Southern Equities Corp (in liq) v Bond* [1999] SASC 441, where Debelle J held in strike-out proceedings that it was a matter for the trial judge to determine whether membership of a board of directors can itself constitute knowing assistance in a breach of duty committed by the company; *Dietrich Steel Ltd v Shar-Dee Towers (1987) Ltd* (Ontario CA 3 February 1999) para 28 (McKinlay JA), applying the Ontario Construction Lien Act 1990, s 13(1)(b).

more likely to be found personally liable where they can be shown to have actively participated in causing their companies to commit primary breaches of duty, than where they have passively failed to prevent such a breach from taking place. It should be borne in mind, though, that these dicta may have more to tell us about the courts' generally cautious attitude to liability for omissions[229] than they have to tell us about the interaction of the rules on liability for dishonest assistance and corporate personality. In the *Wickstead* case, Handley and Cripps JJA held that:[230]

> the statement of claim relevantly alleges that the respondent caused [a company] to apply the appellant's funds to its own use in breach of trust. The respondent was a senior executive of [the company] and as such its "agent". A court of equity would view the conduct of [the company] in converting the appellant's funds to its own use as fraudulent. The statement of claim therefore pleads facts which if pleaded at trial would establish that the respondent "participated in" this fraudulent conduct or "assisted in a dishonest and fraudulent design". On the other hand allegations that the respondent permitted or allowed the breaches of duty by [the company] may not disclose any basis for liability on *Barnes v Addy* principles.

### *(d) Receipt*

The issue we must next address is whether a defendant might ever be held liable for dishonest assistance, where he has received trust property as a consequence of the primary breach. The point has been made already, that liability for dishonest assistance does not depend upon receipt of trust property.[231] But it does not follow from this that a defendant cannot be sued for dishonest assistance where he has in fact received trust property,[232] even though in practice claimants often do not choose to do this.

There are two main reasons for this. The first is that a claimant may prefer instead to assert a proprietary claim to an asset in the recipient's hands, assuming that he is able to identify this asset as the traceable proceeds of his property. The second is that he may prefer to bring a personal action against the recipient which requires a lesser degree of fault than dishonesty, which can be hard to

[229] Discussed in sub-section (b) above.

[230] *Wickstead v Browne* (n 228 above) 16.

[231] See n 43 and text above.

[232] *Baden, Delvaux* (n 8 above) 572–3 (Peter Gibson J); *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 539 (Smellie J): "that the same facts can give rise to both liability as an accessory and a recipient is well established." Smellie J notes *Powell v Thompson* [1991] 1 NZLR 597, where the defendant was found liable under both heads; *Agip (Africa) Ltd v Jackson* [1990] Ch 265, aff'd [1991] Ch 547, where the defendant accountants were sued under both heads, and were found liable as dishonest assistants but not as knowing recipients; and *Nimmo v Westpac Banking Corp* [1993] 3 NZLR 218, where neither cause of action succeeded. At 641, Smellie J concluded that on the facts of the *Equiticorp* case, "both accessory and recipient liability are . . . established." To the same effect are *Standard Chartered Securities Ltd v Lai* (Hong Kong Sup Ct 7 March 1995) paras 79–83 (Rhind J); *Hinds v Uellendahl* [1995] NTSC 104, para 83 (Thomas J); *Lurgi (Australia) Pty Ltd v Culvert Constructions Pty Ltd* [2000] VSC 279, para 26 (Byrne J).

prove—although we may note in passing that in *Air Canada v M & L Travel Ltd*,[233] Iacobucci J thought that if a defendant "received a benefit as a result of the breach of trust, this [might] ground an inference that the stranger knew of the breach" and so acted dishonestly, although he also said that "the receipt of a benefit will be neither a sufficient nor a necessary condition for the drawing of such an inference."[234] A negligence claim at common law might well be easier to make out than a claim in dishonest assistance,[235] and so too might an equitable claim in knowing receipt—although the degree of fault required for the latter type of action is a matter of continuing controversy.[236]

Having said this, however, there are at least two countervailing reasons why a claimant might wish to rely on a claim in dishonest assistance against a defendant who has received trust property. First, the claimant may find it evidentially impossible, or tactically undesirable, to prove that the defendant received his property or its traceable proceeds, ruling out a proprietary claim or a personal claim in knowing receipt. There is little to be said about this, save to make the obvious point that if the claimant cannot prove that the defendant received his property, then he will have to show that the defendant assisted the primary breach in some other way if he is to get anywhere; also, to note Paul Magrath's observation that "commentators are often (rightly) criticized for too readily taking issue with the arguments put forward by practitioners in cases and failing to appreciate the importance of the tactical decision in litigation."[237]

Secondly, the claimant may be able to prove that the defendant has received his property, and wish to do so, but the defendant may be able to defend a receipt-based claim on the ground that he took the property ministerially: ie, that he

[233] [1993] 3 SCR 787, 812, followed in *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 249 (Huband JA); *Sorrel 1985 Limited Partnership v Sorrel Resources Ltd* [2001] 1 WWR 93, 110 (Picard JA). Iacobucci J cited the following authorities for his proposition: *Gray v Johnston* (1868) LR 3 HL 1, 11 (Lord Cairns LC); *Coleman v Bucks and Oxon Union Bank* [1897] 2 Ch 243, 254 (Byrne J); *Shields v Governor and Company of the Bank of Ireland* [1901] 1 IR 222, 228 (Porter MR); *Fonthill Lumber Ltd v Bank of Montreal* [1959] OR 451, 468 (per curiam); *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555, 1586 (Ungoed-Thomas J); *Groves-Raffin Construction Ltd v Bank of Nova Scotia* (1975) 64 DLR (3d) 78, 116–7 (Robertson JA).

[234] See too *Bare Land Condominium Plan 8820814 v Birchwood Village Greens Ltd* (Alberta QB 30 November 1998) para 70 (Nation J): "Although it may be that the nature of certain personal benefits may speak to the knowledge of the trust or the person's participation in the trustee's activity, it is not automatically so. The law requires a participation by the [knowing assistant] in the activity of the [wrongdoing] trustee, which is not found solely by receiving a personal benefit." In *Barret v McCormack* (1999) 4 ITELR 1, the judge at first instance had observed in passing that the defendant accountants had benefited from their assistance in the primary breach because they had received professional fees for the assistance they had given the primary wrongdoer; on appeal, however, counsel "eschewed any reliance upon the fact that the [accountants] received professional fees for work performed by them (there being no evidence that the fees were other than usual fees) as an indication of dishonesty": (1999) 4 ITELR 1, 21 (per curiam).

[235] See the cases discussed in n 182, and accompanying text, above.

[236] The cases are many and well-known, and this is definitely not the place to go through them all again. Nor is this the place to revisit the current debate about the nature of claims in knowing receipt, although this is briefly touched upon in part B, section (2), above.

[237] P A Magrath "Knowing Receipt and Dishonest Assistance: A Wrong Turn" [1999] LMCLQ 343, 344.

took the property as agent for a third party, to whom he owed an immediate duty to account, and who was himself immediately liable to the claimant on the defendant's receipt from the claimant. Most of the relevant cases touching upon ministerial receipt in recent years have concerned claims against banks, and unfortunately these have not always been decided consistently with a proper understanding of the law of unjust enrichment, banking law, and the law of agency. Luckily for us, though, this body of law has recently been analysed in detail by Jonathon Moore, whose excellent doctoral dissertation, *Restitution from Banks*, was completed last year.[238] What follows here is a summary of Moore's argument.[239]

To the extent that claims in knowing receipt belong to the law of unjust enrichment, they lie only against defendants who receive property beneficially for themselves, and they do not lie against defendants who receive ministerially as agents for third parties. To distinguish a beneficial recipient from a ministerial recipient, the key question is not whether the recipient takes beneficial title to the property (as is often incorrectly supposed),[240] nor is it whether the recipient has passed the property over to a principal subsequent to receipt. Rather, the key question is whether the defendant was liable to account to a principal for the property received from the moment of receipt, with the twin results that the defendant was not globally enriched by his receipt, and that the principal was himself liable to the claimant from the moment when the defendant received the property as his agent.[241] On this understanding of ministerial receipt, a defendant who receives property ministerially which was transferred to him in breach of trust or other fiduciary duty may therefore be liable for dishonest assistance, but he cannot be liable for knowing receipt.[242]

Applying these principles to determine whether a bank which has received trust property should be sued in dishonest assistance or knowing receipt, one

[238] J P Moore *Restitution from Banks* (Unpublished DPhil dissertation, University of Oxford, 2000).

[239] I am most grateful to Dr Moore for permitting me to reproduce material taken from his dissertation in the paragraphs which follow. These are merely a summary of his main points in relation to ministerial receipt as a defence to equitable claims, and a close reading of the whole of his dissertation is warmly recommended. To an extent the aspect of his work discussed here is anticipated by P Birks "The Burden on the Bank" in F D Rose (ed) *Restitution and Banking Law* (Mansfield Press Oxford 1998) 189, 209–210.

[240] Moore (n 238 above) 213: "Beneficial receipt is not a receipt which makes the recipient better off. It is a receipt by someone acting on his own behalf and not as agent."

[241] Moore (n 238 above) 225–247, where Moore discusses a series of cases establishing that a principal is liable to a claimant in unjust enrichment from the moment of his agent's receipt of property from a claimant, regardless of whether the agent pays the money over to the principal: *National Westminster Bank Ltd v Barclays Bank Ltd* [1975] QB 654; *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1981] Ch 105; *ANZ Banking Group Ltd v Westpac Banking Corp* (1988) 164 CLR 662; *Portman BS v Hamlyn Taylor Neck (a firm)* [1998] 4 All ER 202, 207 (Millett LJ).

[242] Moore (n 238 above) 160–176, where Moore discusses two sets of cases, the first establishing that agents of trustees are not liable in knowing receipt for receiving trust property on behalf of the trustee, and the second establishing that agents of third parties are not liable in knowing receipt for receiving trust property on behalf of the third party.

must first distinguish the situation where the property has been deposited with the bank by the account-holder from the situation where the property has been deposited with the bank by a third party. In the first situation, the bank always receives the money beneficially, and never receives it ministerially: there is simply a loan of money from the account-holder to the bank, or if the account is overdrawn, a repayment of the debt owed to the bank by the account-holder. Hence, in this first situation the bank is potentially liable to claims in knowing receipt where a trustee or fiduciary himself deposits trust money into his personal account,[243] and cases to the contrary, which suggest that a bank in this situation can only be liable as a dishonest assistant, are incorrect in principle.

So, in *Polly Peck International plc v Nadir (No 2)*,[244] for example, a claim was brought by PPI in respect of money which it had paid into Central Bank's account with Midland Bank. This money was received beneficially and not ministerially by Central Bank, suggesting that PPI's claim should have been in knowing receipt,[245] and that Millett J must have been wrong to suppose that the case was one of knowing assistance.[246] On appeal, Scott LJ divided the claim into two,[247] according to whether Central Bank had subsequently credited its own account-holder IBK's account in respect of sums expressed in sterling (the sterling transfers, giving rise to a claim in "knowing assistance" in Scott LJ's view), or in respect of sums expressed in Turkish lira (the Turkish lira transfers, giving rise to a claim in "knowing receipt" in Scott LJ's view). However, as Moore rightly observes,[248] the receipts by IBK were not the receipts in issue in the case, as a careful reading of PPI's statement of claim makes clear:[249] the receipts in issue were the receipts by Central Bank from PPI.

Scott LJ's division of the *Polly Peck* claim into two was doubted for a different reason in two New Zealand cases: *Nimmo v Westpac Banking Corp*[250] and *Cigna Life Insurance New Zealand Ltd v Westpac Securities Ltd*.[251] Here, Blanchard J[252] and Grieg J[253] respectively preferred a "net benefit approach," holding that a bank could not be said to have beneficially received money for the purposes of a claim in knowing receipt where it had paid deposits back to the account holder. This approach was also taken by Auld LJ in *Macmillan Inc v Bishopsgate*

[243] As in eg, *Director, Real Estate and Business Brokers v NRS Mississauga Inc* (2001) 194 DLR (4th) 527.
[244] [1993] BCLC 187.
[245] Moore (n 238 above) 180.
[246] *Polly Peck International plc v Nadir (No 2)* (n 244 above) 191: "I am inclined to think that there is no evidence of receipt within the relevant meaning of the word".
[247] *Polly Peck International plc v Nadir (No 2)* (n 244 above) 204.
[248] Moore (n 238 above) 179–80.
[249] *Polly Peck International plc v Nadir (No 2)* (n 244 above) 202 (Scott LJ): "in the premises the Central Bank received the said sums to the Central Bank's Midland account with actual knowledge that the transfer of the same had been procured by Mr Nadir in breach of his fiduciary duty."
[250] [1993] 3 NZLR 218.
[251] [1996] 1 NZLR 80.
[252] *Nimmo v Westpac Banking Corp* (n 250 above) 225.
[253] *Cigna Life Insurance New Zealand v Westpac Securities Ltd* (n 251 above) 86.

*Investment Trust plc (No 3)*,[254] but as Moore persuasively argues,[255] it improperly takes account of disenrichments subsequent to, or simultaneously with, the bank's receipt, which are relevant only to the question whether the bank has a defence, and which do not properly go to the question whether the bank was enriched in the first place.

Turning to the second situation,[256] where cash is deposited with a bank by a person other than the account holder, or the bank's own account with a central clearing bank is credited as a result of instructions from such a person, then in principle the bank always takes the proceeds of the transaction ministerially as agent for the account-holder—and it follows from this that the bank cannot be liable in knowing receipt, but may be liable for dishonest assistance. It has been hard for the courts and academic commentators to accept this proposition, although cases can be marshalled in its support. One reason for their reluctance may be that they have not always understood that a bank which receives a third-party deposit on its customer's behalf does not receive "beneficially" simply because it takes good title to the money and thereafter uses the money as its own: as has been explained already, "beneficial receipt" as distinguished from "ministerial receipt" of money entails not merely that a defendant takes good title to the money, but also that the defendant should not have to account for an equivalent sum to a principal who is himself legally liable to the claimant from the moment of the defendant's receipt.[257] A second, related reason may be that it is not immediately obvious what is going on when a bank receives a third-party deposit on a customer's behalf, particularly where the account is overdrawn. Properly understood, though, such transactions always work in the same way, regardless of the state of the account between the bank and the customer: first, the bank receives the deposit ministerially, as agent for its customer; then, in a separate transaction, the bank either borrows the money from its customer and credits the amount in its books as a debt which it owes to the customer, or where his account is overdrawn, applies the amount on his behalf in reduction of the debt which he owes to the bank.

Authority for this analysis, at least where the customer's account is in credit, can be found in *Agip (Africa) Ltd v Jackson*,[258] where Millett J stated that:

[254] [1996] 1 WLR 387, 409.

[255] Moore (n 238 above) 189–190.

[256] Discussed by Moore (n 238 above) 192–210 and 250–256.

[257] Cf L D Smith "Unjust Enrichment, Property, and the Structure of Trusts" (2000) 116 LQR 412, 433: "Banks always receive beneficially, even if they are acting as agents." See too S Gleeson "The Involuntary Launderer: The Banker's Liability for Deposits of the Proceeds of Crime" in P Birks (ed) *Laundering and Tracing* (Clarendon Press Oxford 1995) 115, 126–7; R Cranston, *Principles of Banking Law* (OUP Oxford 1997) 207–8; M Bryan "Recovering Misdirected Money from Banks" in F D Rose (ed) *Restitution and Banking Law* (Mansfield Press Oxford 1998) 161, 181–7.

[258] [1990] Ch 265, 291, aff'd [1991] Ch 547. See too *Compagnie Commerciale Andre SA v Artibell Shipping Co Ltd* 2001 SC 653, 661–2 (Lord Macfadyen): "There is, no doubt, a sense in which money paid to a bank to the credit of the account of one of its customers becomes, on receipt, the bank's money—as Lord Mackay said in *Royal Bank of Scotland v Skinner* [1931 SLT 382, 384], it is 'simply consumed by the banker.' But in that simple situation, the bank is not thereby enriched,

The essential feature of [claims in knowing receipt] . . . is that the recipient must have received the property for his own use and benefit. This is why neither the paying nor the collecting bank can normally be brought within it.

There are also earlier cases which support the proposition that the same analysis applies where misdirected money is credited to an overdrawn account by a third party: in *British North American Elevator Co v Bank of British North America*,[259] the Privy Council held a bank liable as an accessory to a breach of trust where it had "knowingly [become a party] to a misapplication of what were trust funds"[260] paid into an overdrawn account by a person other than the bank's customer; and again, in *Bank of New South Wales v Vale Corp (Management) Ltd*,[261] the corporate manager of a unit trust wrongfully deposited money it had received as subscriptions for units into the overdrawn account of companies belonging to the same corporate group, and the New South Wales Court of Appeal considered that "it was not the [defendant] bank, but rather it was the [corporate group] which was the recipient of almost the entirety of the moneys paid out of [the manager's] account."[262]

Against this line of authority are a number of decisions and dicta, which Moore argues are wrong in principle. They include Millett J's further statement in the *Agip* case that:[263]

if the collecting bank uses the money to reduce or discharge the company's overdraft . . . it receives the money for its own benefit.

Interestingly, Lord Millett (as he has since become) shifted his position after the *Agip* case, writing extra-judicially that a bank can only be said to have received third-party deposits beneficially where there has been "some conscious appropriation of the sum paid into the account in reduction of the overdraft."[264] However, as Moore points out,[265] when a bank receives a payment from a third party who designates the relevant account at the time of his payment, the bank has no choice which account to credit with the money, and so is not in a position to make a "conscious appropriation" of the third party's deposit.

because it grants an immediate obligation of corresponding amount to its customer. Receipt by the bank in that way would not . . . afford the necessary foundation for an argument that in the event of the money becoming repayable by the customer to the payer, the bank had been unjustly enriched."

259 [1919] AC 658.

260 *British North American Elevator Co v Bank of British North America*, n 259 above, 663 (Viscount Haldane).

261 NSWCA 21 October 1981.

262 *Bank of New South Wales v Vale Corp (Management) Ltd* (above n 261) (Street CJ).

263 [1990] Ch 265, 292, aff'd [1991] Ch 547. See too *Foxton v Manchester and Liverpool District Banking Co* (1881) 44 LT 406; *Coleman v Bucks and Oxon Union Bank* [1897] 2 Ch 243; *Citadel General Assurance Co v Lloyds Bank Canada* [1997] 3 SCR 805. The latter case was also followed on this point in *Peppiatt v Nichol* (Ontario Ct (Gen Div) 21 August 1998) paras 316–346 (Chadwick J).

264 Sir P Millett (now Lord Millett) "Tracing the Proceeds of Fraud" (1991) 107 LQR 70, 83, n 46, considered in *Westpac Banking Corp v M M Kembla New Zealand Ltd* [2001] 2 NZLR 298, 316–7 (per curiam).

265 Moore (n 238 above) 212–3.

## 4 Dishonesty

### *(a) Pleading Dishonesty*

Defendants are entitled to have their conduct judged against distinct allegations of dishonesty as pleaded,[266] and "where fraud has not been sufficiently pleaded, it is . . . no answer to say that if it had been sufficiently pleaded no further evidence would have been called for the defence," for the "presence or absence of a charge of fraud may . . . affect the whole manner in which a defence is conducted,"[267] and "what matters is that a defendant should have had adequate warning by the pleadings as to the issues of fact that are to be raised against him."[268] For this reason, it is "generally no answer to a demand for particulars . . . that the defendant already knows the information [:] . . . the defendant is entitled to pin the [claimant] down by his or her pleading so that the case to meet will be known."[269] Even in "the special cases of breach of trust and dishonesty," however, the pleadings "are to contain and to contain only not every last possible detail but a statement in a summary form of the material facts on which the [claimant] relies and not the evidence and . . . such statement is to be as brief as the nature of the case admits."[270]

"It is not necessary to use the word 'fraud' or 'dishonesty' [in the pleadings] if the facts which make the conduct complained of fraudulent are pleaded; but, if the facts pleaded are consistent with innocence, then it is not open to the

[266] *Armitage v Nurse* [1998] Ch 241, 251 (Millett LJ), following *Davy v Garrett* (1878) 7 Ch D 473, 489 (Thesiger LJ). See too Practice Direction, Pt 16, para 11.2(1), referring to an allegation of fraud, but clearly applicable also to an allegation of dishonesty. A similar principle underlies the decision in *Wakelin v Read* (CA 17 March 2000), that the Pensions Ombudsman was not entitled to determine the question whether a pension scheme member had dishonestly assisted the former trustee to commit a breach of trust, on the basis that the member and the former trustee had entered "a plot", a view of the facts which had never been argued by the present trustees and which the member had therefore never had the chance to rebut. (The Ombudsman had resolved the dispute between the parties solely on the strength of written documents.) Under the Code of Conduct of the Bar of England and Wales, para 606(c), counsel must have reasonably credible material to enable fraud properly to be pleaded, but the Code does not require the full disclosure of this material to the defendant: *Rigby v Decorating Den Systems Ltd* (CA 15 March 1999). In *Brown v Bennett (No 2)* (Ch D 18 October 2000) Neuberger J considered that counsel were very probably in breach of this duty, and added for good measure that it was a matter for "wonder" that the claimants' "very speculative" case had been funded by the Legal Aid Board for over four years when "the grounds for making the serious, and in many cases very serious, allegations raised on [the claimants'] behalf against the defendants [did] not appear . . . to exist." Notwithstanding these comments, however, Neuberger J subsequently declined to make a wasted costs order against the claimants' lawyers, partly because he concluded, on further reflection, that their decision to plead dishonesty was one that a reasonable lawyer might have taken, and partly because the claimants refused to waive privilege: [2002] 1 WLR 713.

[267] *Belmont Finance Corp Ltd v Williams Furniture Ltd* [1979] Ch 250, 270 (Orr LJ).

[268] *Gray v New Augurita Porcupine Mines Ltd* [1952] 3 DLR 1, 13–14 (Lord Radcliffe), followed in *Aequitas Ltd v Sparad No 100 Ltd (formerly Australian European Finance Corp Ltd)* [2001] NSWSC 14 (Austin J).

[269] *Montreal Trust Co of Canada v Hickman* [2001] NFCA 42, para 60 (Green JA).

[270] *HR v JAPT* (1998/1999) 2 OFLR 252, 284 (Lindsay J).

court to find fraud."[271] Nor is it necessary to provide particulars of knowledge in a fraud claim, provided that actual knowledge is pleaded—although it is open to the defendant to seek further particulars of such a pleading of actual knowledge, and "if there is a pleading that a person 'knew or ought to have known' particular matters, then that rolled-up plea should be particularized."[272] Moreover, in relation to a pleading of dishonest assistance, "it may not be enough to plead knowledge that a plan was dishonest without more, if the pleaded facts are not sufficient to establish that the plan was dishonest,"[273] and "in order to allege fraud it is not sufficient to sprinkle a pleading with words like 'wilfully' or 'recklessly' (but not 'fraudulently' or 'dishonestly') . . . [as this] may still leave it in doubt whether the words are being used in a technical sense or merely to give colour by way of pejorative emphasis to the complaint."[274] In the particular context of a claim for dishonest assistance, "each defendant is entitled to know the role which he or she is alleged to have played in the alleged attempts to fraudulently dispose of the properties in question or in their knowing and dishonest assistance and participation therein as the basis for the claim that they are liable to compensate the [claimant] for the alleged improper disposition of the properties."[275]

[271] *Armitage* (n 266 above) 251 (Millett LJ), following *Belmont Finance Corp Ltd v Williams Furniture Ltd* [1979] Ch 250, 268 (Buckley LJ): "The facts alleged may sufficiently demonstrate that dishonesty is allegedly involved, but where the facts are complicated this may not be so clear, and in such a case it is incumbent upon the pleader to make it clear when dishonesty is alleged. If he uses language which is equivocal, rendering it doubtful whether he is in fact relying on the alleged dishonesty of the transaction, this will be fatal; the allegation of dishonesty will not have been pleaded with sufficient clarity." Cf *Burton v Global Benefit Plan Consultants Inc* (1999) 178 Nfld & PEIR 169, 176 (Orsborn J): "Where a cause of action is dependent on activity (and knowledge of activity) that is fraudulent and dishonest, the statement of claim must make that assertion clearly, and conduct which is said to be fraudulent and dishonest must be clearly identified and so characterized. I appreciate . . . that 'fraudulent and dishonest' may be viewed as a characterization of facts rather than as a factual assertion in and of itself; nonetheless, the underlying facts which are said to support that characterization must be clearly asserted and so characterized in the statement of claim."

In the event that leave is granted to serve a defendant outside the jurisdiction on the basis of pleadings which present a particular head of claim on a legal basis other than dishonest assistance, the claimant may not subsequently argue that the court was justified in granting leave because the pleaded facts also support an alternative claim in dishonest assistance: *Metall und Rohstoff AG v Donaldson, Lufkin & Jenrette Inc* [1989] 3 WLR 563, 581 (Slade LJ), distinguishing *Re Vandervell's Trusts (No 2)* [1974] Ch 269, 321 (Lord Denning MR). See too *DSQ Property Co Ltd v Lotus Cars Ltd* The Times 28 June 1990 (Dillon LJ): "The case of dishonesty must on any view be pleaded with considerable particularity, in order that the defendant can know adequately the case he is called on to meet. I do not believe—*pace* Lord Denning's general rule in *Vandervell*—that in such a complex case it is possible to plead a case of constructive trust adequately without using the words 'constructive trust', or some other wording which would indicate to the defendant that what was asserted was at least one of the situations Lord Selborne had in mind [in *Barnes v Addy* [1874] LR 9 Ch App 244, 251–2]."

[272] *Rigby v Decorating Den Systems Ltd* (CA 15 March 1999).

[273] *Rigby v Decorating Den Systems Ltd* (above n 272) (Peter Gibson LJ), construing *Brown v Bennett* [1998] 2 BCLC 97, 107 (Rattee J).

[274] *Armitage v Nurse* (n 266 above) 257 (Millett LJ).

[275] *Montreal Trust Co of Canada v Hickman* [2001] NFCA 42, para 57 (Green JA).

It is usually harder to establish an allegation of dishonesty than an allegation of negligence, as "the more serious the allegation the less likely it is that the event occurred and, hence, the stronger should be the evidence before the court concludes that the allegation is established on the balance of probability."[276] In an application for summary judgment the pleaded facts must therefore be particularly clear before a court is likely to reach such a conclusion.[277] Where evidence of dishonesty is given by a defendant's alleged collaborators in a fraudulent scheme, such independent evidence as there may be which supports their allegations must be anxiously considered before a finding of dishonesty is made.[278] In the event that the proper inference to be drawn from the pleaded facts is that the defendant has acted dishonestly, then the burden of proof will be shifted to him, and if he elects to call no evidence then the court may legitimately infer dishonesty even if he could have given a credible alternative explanation of his conduct.[279] In the event that he does appear in the witness box, the defendant must be given the opportunity to answer the claimant's allegations of dishonesty in cross-examination,[280] and his credibility and statements as a witness must be tested against the objective facts, the overall probabilities, and the motives of those involved.[281]

[276] *Re H and Others (Minors) (Sexual Abuse: Standard of Proof)* [1996] AC 563, 586 (Lord Nicholls); cf *Bater v Bater* [1950] 2 All ER 458, 459 (Denning LJ). Lord Nicholls' comments in *Re H* were held to govern the standard of proof in an action for dishonest assistance by Mance LJ (sitting as a judge at first instance) in *Grupo Torras SA v Al-Sabah (No 5)* (QBD (Comm Ct) 24 June 1999), aff'd on this point [2001] Lloyd's Rep Bank 36, 45 (per curiam).

[277] Cf *Houghton v Fayers* [2000] Lloyd's Rep Bank 145, 149 (Nourse LJ); *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734, 758 (Rimer J): "In theory . . . I ought to be able to form a decision on whether [the defendant] has been dishonest merely by looking at the papers and ascertaining precisely what he did do. I will simply say that I would not find that an easy exercise on the facts of this case, and would have considerable reservations about making a final finding of dishonesty against a defendant on a summary application such as this."

[278] *Dubai Aluminium Co Ltd v Salaam* [2001] QB 113, 128 (Evans LJ).

[279] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, 293–4 (Millett J). Cf *Norwich Union Fire Insurance Soc Ltd v Central Auto Salvage (London) Ltd* (CA 30 July 1993), (Evans LJ): "There may be answers consistent with [the defendant's] innocence to [questions about his behaviour arising from the pleaded facts], and if so, the answers lie within [the defendant's] own knowledge. In these circumstances, . . . his deliberate silence adds weight to the inference of guilty knowledge which the plaintiffs assert, and the evidence as a whole is no longer consistent or equally consistent with innocence"; *Turner v TR Nominees Pty Ltd* (1995) 31 ATR 578, 588 (Santow J): "the . . . defendant gave no evidence. Accordingly a *Jones v Dunkel* [(1959) 101 CLR 298] inference may legitimately be drawn that any evidence he could have given would not have assisted his case." Santow J accordingly found that the defendant had acted dishonestly, even though he observed later on in his judgment at 594 that "there was no attempt to conceal what was done and . . . this suggests an honest, if wholly mistaken, view as to its legitimacy." For the same point, see also *Van Vliet Construction 1988 Ltd v Jaeger* (British Columbia Sup Ct 9 Jan 1998) paras 38–9 (Pitfield J); *Barret v McCormack* (1999) 4 ITELR 1; *Kenna & Brown Pty Ltd (in liq) v Kenna* [1999] NSWSC 533, para 213 (Bergin J). But NB a court should not draw any inference adverse to a defendant because of his refusal to waive the privilege attaching to expert legal advice received in respect of the matters in issue: *Ferrotex Industrial Ltd v Banque Français de l'Orient* (QBD (Comm Ct) 4 July 2000), para 35 (Morison J).

[280] *Aroso v Coutts & Co* [2002] 1 All ER (Comm) 241, 256, para 41 (Lawrence Collins J).

[281] *Armagas Ltd v Mundogas SA* [1985] 1 Lloyd's Rep 1, 57 (Robert Goff LJ), followed in *Grupo Torras SA v Al-Sabah (No 5)* (QBD (Comm Ct) 24 June 1999), impliedly approved on this point in [2001] Lloyd's Rep Bank 36, 43 and 47 (per curiam).

Once a judge has reached a final decision on the point one way or the other, an appellate court is unlikely to reverse him, as it will do so only where "there was no evidence to support [his] finding" or where "it was against the weight of the evidence as a whole."[282] In forming its own view of the evidence an appellate court must usually bear in mind that the trial judge is better placed than the appellate court to determine the credibility of witnesses; at the same time, it must also "stand back and seek to evaluate the whole of the relevant evidence, uninfluenced as far as possible by the finding which the trial judge made and which is the subject of the appeal."[283]

### *(b) Dishonesty and social mores*

Whether a defendant to a claim in dishonest assistance has acted dishonestly is essentially a question of fact for the court to determine by measuring his actions against the "standards of right thinking members of society."[284] These are objective standards, in the sense that the defendant's personal moral code is not the relevant yardstick: he is dishonest if he fails to live up to social norms even if he acts in accordance with his own moral viewpoint—so-called "Robin Hood" dishonesty.[285] So, for example, in

[282] *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2001] Ch 437, 448 (Nourse LJ).

[283] *Dubai Aluminium Co Ltd v Salaam* [2001] QB 113, 129 (Evans LJ). The same point is also made in *Grupo Torras SA v Al-Sabah (No 5)* [2001] Lloyd's Rep Bank 36, 45–6 (per curiam), following *Benmax v Austin Motor Co Ltd* [1955] AC 370, 375–6 (Lord Reid); unusually, the Court of Appeal in the *Grupo Torras* case reversed Mance LJ's finding of dishonesty with regard to one of the appellants, accepting that his story was far-fetched because it had been fed to him by others in order to compromise him: *Gruppo Torras SA v Al-Sabah (No 5)* above, 42–9. For other rare cases in which findings of dishonesty (or honesty) have been reversed on appeal, see *Armagas Ltd v Mundogas SA* [1985] 1 Lloyd's Rep 1; *National Justice Compania Naviera SA v Prudential Assurance Co Ltd* [1995] 1 Lloyd's Rep 455; *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511. And cf *Mortgage Express Ltd v S Newman & Co (a firm)* [2000] PNLR 298, where Hart J concluded that the defendant had been honest on the strength of facts which were not properly admitted in evidence. On appeal the case was accordingly returned for a retrial: [2001] PNLR 86, esp 99 (Aldous LJ), stressing that the judge had been "impressed by [the defendant's] honesty" in the witness box, but concluding "with great reluctance" that a new trial would be necessary because "it would not be right for this court to conclude that Ms Newman was dishonest when the judge had concluded to the contrary, albeit upon a basis which I have held to be flawed. A conclusion as to whether Ms Newman acted honestly can only be reached after seeing Ms Newman give her evidence." The claim by Mortgage Express was then settled, but the defendant was later found to have acted honestly in third party proceedings brought by the defendant against the Solicitors' Indemnity Fund: Ch D, 1 March 2001.

[284] *Mortgage Express Ltd v S Newman & Co (a firm)* [2001] PNLR 86, 100 (Aldous LJ), affirming Millett J's observation in *Agip (Africa) Ltd v Jackson* [1990] 1 Ch 265, 295, that dishonesty is "essentially a jury question." Millett J cannot have meant this literally. Actions for dishonest assistance were historically brought in the Chancery courts where juries formed no part of the court process, and even in the context of common law actions for fraud, the right to trial by jury was effectively abolished in England and Wales by the 1930s: D J Ibbetson, *A Historical Introduction to the Law of Obligations* (OUP Oxford 1999)188–9.

[285] *Grupo Torras SA v Al-Sabah (No 5)* [2001] Lloyd's Rep Bank 36, 60 (per curiam). See too *Consul Developments Pty Ltd v DPC Estates Pty Ltd* (1975) 132 CLR 373, 398 (Gibbs J): an intermeddling stranger may be found liable where "his own moral obtuseness has prevented him from recognising an impropriety that would have been apparent to an ordinary man." But cf *Aequitas Ltd v Sparad No*

*Turner v TR Nominees Pty Ltd*,[286] a case in the New South Wales Supreme Court, the defendant director of a trustee company caused the company to reimburse him out of trust funds for expenditure he had incurred for his son, the claimant beneficiary. The defendant was also a beneficiary under the trust, and he could legitimately have taken the trust money for himself *qua* beneficiary. But still Santow J held that:[287]

Even if the . . . defendant may have thought himself justified in reimbursing himself and others for expenditures he had made for his son, the fact remains that he did so out of his son's money. . . . That he may have thought this not in breach of trust does not remove the conduct from the scope of accessory liability . . . Dishonesty, used in the broad sense of Lord Nicholls' formulation, still applies here. What was done was deliberate and in circumstances where the . . . defendant should have known that he was dealing with the plaintiff's money, however morally justified he may have thought himself in doing so.

The right-thinking members of society against whose moral standards a defendant's conduct is judged are obviously an imaginary construct. Hence the question arises, what sources the courts might draw upon besides their own moral outlook to endow this austere cast of characters with a point of view. The cases suggest that two matters in particular can be taken into consideration in appropriate circumstances. First, the courts may admit evidence of accepted practices within particular socio-economic groups or countries. So, for example, in *Industrial Concrete Products Bhd v Concrete Engineering Products Bhd*,[288] a case in the Malaysian High Court, James Foong J considered that it was "the norm in our local social condition," and therefore honest, for a party engaged in commercial negotiations with the purported director of a company to believe his representations that he is actually authorized to represent the company, particu-

*100 Ltd (formerly Australian European Finance Corp Ltd)* [2001] NSWSC 14, where Austin J found that an assistant's actions "showed a kind of moral obtuseness, in disregard for the rights" of third parties who would be injured by the primary breach, and yet still concluded that he had not acted dishonestly. With respect, it seems doubtful whether this conclusion can properly have been open to him.

[286] (1995) 31 ATR 578.

[287] *Turner v TR Nominees Pty Ltd* (n 286 above) 592. At 594, Santow J also held that "there was no attempt to conceal what was done and . . . this suggests an honest, if wholly mistaken, view as to its legitimacy." However, Santow J seems to have been unable to conclude that the defendant had therefore been an honest fool rather than a knave, because the defendant gave no evidence on his own behalf, and the other pleaded facts supported an inference of dishonesty.

[288] [2001] 2 MLJ 332, 364–5: "One does not demand from a formidable counterpart whom you have heard from your market information that he has just secured control of a public listed company to have sight of his company's M & A or, for that matter, a board or members' resolution delegating him with such authority during negotiations . . . one must not lose sight of the fact that commercial people are not lawyers. . . . A businessman's normal approach is that you have goods to sell, please show them to me, and if they suit my purpose, with the right price I shall purchase them, unless there are circumstances which [arouse] my suspicion that you have obtained the goods by unlawful means." Cf the cases cited above at n 14, establishing that constructive notice has only a limited role to play in the context of commercial transactions, but note that the English Companies Act 1985, s 722A, which abolishes the doctrine that outsiders dealing with a company are fixed with constructive notice of its registered constitutional documents, has not been brought into force.

larly if the company does all that he says it will do. And again, in *Grupo Torras SA v Al-Sabah (No 5)*, Mance LJ (sitting as a judge at first instance) held of a Spanish company director that:[289]

the Spanish climate tolerated without compunction the type of dishonesty in relation to exchange control and tax which Mr Soler believed was in issue. In these circumstances, I would not treat Mr Soler as having acted dishonestly.

Secondly, however, and perhaps casting some doubt on Mance LJ's approach, the courts have tended to assume that it cannot be honest of a defendant to engage in behaviour which has been criminalized or held to constitute a civil wrong.[290] So, for example, in *Barret v McCormack*,[291] the appellant accountants sought to avoid an imputation of dishonesty by arguing that:

in the business environment that prevails in Vanuatu, with its tax haven status and confidentiality laws, professional people in the position of the appellants do not make the searching inquiries of their clients that may be made in other places.

But the Vanuata CA firmly rejected this argument, holding that it was:

to misunderstand the scope and purpose of [the Vanuatu business and corporate secrecy laws] to suggest that they lower the standards of probity required of the appellants in this case. The secrecy laws are not intended to lower the standards of honesty expected of officers of companies in the management of their affairs or in transactions with third parties. The provisions provide a guarantee against disclosure of the specified information about the affairs of companies and the transactions of companies, but the legislation assumes that those affairs and transactions will be carried on in accordance with the laws of the Republic of Vanuatu.

Again, in *Glenko Enterprises Ltd v Keller,*[292] a case in the Manitoba Court of Appeal, Huband JA accepted that it is common practice in the Canadian

[289] QBD (Comm Ct) 24 June 1999, not considered on appeal: [2001] Lloyd's Rep Bank 36. See too *Arab Monetary Fund v Hashim (No 9)* (Ch D 29 July 1994) (Chadwick J): "If . . . the basis of . . . a ['*Barnes v Addy* constructive trust claim'] is dishonesty or lack of probity on the part of the defendant, then it must be right to judge honesty or dishonesty in the light of all relevant circumstances; and those circumstances must include relevant provisions of local law." And cf *Dubai Aluminium Co Ltd v Salaam* [1999] 1 Lloyd's Rep 415, 452–3 (Rix J) (not considered on appeal: [2001] QB 113), accepting that evidence of Dubai custom and practice should inform his decision with regard to the honesty of the defendants' actions inside Dubai, but considering that it was "capable of having little, if any, bearing on the acts of the parties . . . carried on outside Dubai"; on the facts, Rix J held that the defendants had been dishonest by Dubai standards as well as English standards.

[290] But cf *Belmont Finance Corp Ltd v Williams Furniture Ltd* [1979] Ch 251, 270 (Buckley LJ): "'Crime' and 'fraud' are not synonymous; a criminal act may well be committed without any fraud or dishonesty."

[291] (1999) 4 ITELR 1, 28 (per curiam).

[292] [2001] 1 WWR 229. Cf *Sorrel 1985 Limited Partnership v Sorrel Resources Ltd* [2001] WWR 93, 113 (Picard JA), holding that insufficient evidence had been presented to warrant the trial judge's finding that it was accepted practice in the oil and gas industry for limited partnership funds to be used to finance the general partner's operations in breach of the general partner's fiduciary obligations to the limited partnership. A similar but distinct question also arose in *Transamerica Occidental Life Insurance Co v Toronto-Dominion Bank* (1999) 173 DLR (4th) 468, 483–7, concerning expert evidence on the question whether it was insurance industry practice for an insurer's agent to hold premiums in a separate trust account. Osborne JA held that this evidence should have been

construction industry for contractors to operate a single general account in which funds impressed with a statutory builders' lien become mixed with other funds, and out of which the contractor's general obligations are paid, but even so he considered that:[293]

> whatever the industry practice may be, it cannot excuse the appropriation of trust funds contrary to the provisions of the Builders' Liens Act.

This leads us to the question whether the court should take a defendant's knowledge or ignorance of the law into account when assessing his behaviour. This question will be addressed below, in sub-section (d).

### *(c) Dishonesty and knowledge*

"A trustee who acts with the intention of benefiting persons who are not objects of the trust is not the less dishonest because he does not intend to benefit himself,"[294] and a man who steals another man's wallet from his pocket "will not escape a finding of dishonesty simply because he sees nothing wrong in such behaviour."[295] But a trustee who redirects trust funds to a stranger does not act dishonestly if he knows that the beneficiaries wish him to do so (although he still commits a breach of duty and should obtain their written consent to protect himself); and a man who knows that the wallet in another man's pocket is his own, stolen from him five minutes earlier, is not dishonest if he retakes his property. These examples tell us that we cannot meaningfully assess the honesty of a person's behaviour without investigating the surrounding circumstances and what he knew of them—in Hirst LJ's words, "dishonesty and knowledge (of some sort) are rather like the chicken and the egg."[296] This tells us in turn that notwithstanding Lord Nicholls' efforts to play down the significance of knowledge in the *Royal Brunei* case, it remains an integral part of his test for liability as a dishonest assistant.

Of course Lord Nicholls was well aware that dishonesty has "a strong subjective element in that it is a description of a type of conduct assessed in the light of what a person actually knew at the time, as distinct from what a reasonable person would have known or appreciated."[297] His purpose in the *Royal Brunei* case

assessed against written evidence of the parties' agreements at full trial, and should not have been rejected without proper consideration by the motions judge.

[293] *Glenko Entreprises Ltd v Keller* (n 292 above) 242.

[294] *Armitage v Nurse* [1998] Ch 241, 251 (Millett LJ). Likewise, assistants in a breach of trust or fiduciary duty can be dishonest even though they take no benefit for themselves: *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734, 756 (Rimer J), seeing no special significance in the fact that it was "not suggested that [the defendant] personally derived any benefit." The significance of the fact that a defendant *has* derived a benefit from a primary breach in which he has assisted is touched upon in the text to nn 233 and 234 above.

[295] *Royal Brunei* (n 1 above) 389 (Lord Nicholls).

[296] *Three Rivers DC v Governor and Company of the Bank of England (No 3)* [2000] 2 WLR 15, 62 (Hirst LJ); not considered on appeal: [2000] 2 WLR 1220.

[297] *Royal Brunei* (n 1 above) 389.

was not to deny that knowledge was important, but to refocus our attention on why it is important. His reference in the *Royal Brunei* case to a "'gradually darkening spectrum' explains the difficulties inherent in the 'sort' of knowledge required"[298] by the *Baden, Delvaux* jurisprudence, and with these difficulties in mind, his aim was to eliminate some distracting and unhelpful terminology. It was not to deny the importance of the problem which the terminology was created to address. Whether this praiseworthy goal will be achieved in the long term remains to be seen. We may doubt it when we read Nourse LJ's statement in *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*,[299] that the *Baden, Delvaux* categorization "is often helpful in identifying different states of knowledge which may or may not result in a finding of dishonesty for the purposes of knowing assistance"—but other judges have shown themselves less attached to this way of approaching the matter.[300]

### *(d) Knowledge of What?*

In whatever terms we cast our discussion of a defendant's knowledge, it is plain that most of the specific things that a defendant must have known before he can be said to have acted dishonestly will vary greatly from case to case. If he has bought property at "what appears to be a bargain price," it is not dishonest of him to proceed with the sale without inquiries unless "the mode and terms of the proposed sale" and "the open market value" are indicative of fraud by the vendor's representatives.[301] If he has participated in a breach of trust which was created by contract "then whether [he] knew of the trust will depend on his . . . familiarity or involvement with the contract".[302] If he has assisted in a share transaction, then it may be relevant that the buyers never complain about the shares which they receive, but on the other hand, he should realize that if the share transactions are fraudulent, then "the people buying shares might not be complaining for the very reason that they [are] oblivious to the fraud."[303] If he

[298] *Three Rivers DC v Governor and Company of the Bank of England* (n 296 above) 62 (Hirst LJ).
[299] [2001] Ch 437, 455. See too *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 523 (Nourse LJ). Cf *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 640 (Smellie J): "In practical terms, although the judgment [in the *Royal Brunei* case] strongly discourages further reference to the *Baden* scale, it means that only if the plaintiffs establish *Baden* categories (i), (ii) or (iii) will their dishonest accessory causes of action succeed." Smellie J's understanding of the *Baden* categories is out of line with the English authorities cited in n 16, above.
[300] See eg, *Mortgage Express Ltd v S Newman & Co (a firm)* [2001] PNLR 86, 100 (Aldous LJ): whether a defendant has acted dishonestly "may not be an easy question to answer, but it is the sort of question that judges and juries throughout the country answer every day without needing to analyse large numbers of authorities"; *Tri-Star Customs and Forwarding Ltd v Denning* [1999] 1 NZLR 33, 38 (per curiam): "The deliberate shutting of eyes to what is an obvious fact may well lead to a finding or assist in drawing an inference of knowledge in a particular set of circumstances. But the need to have regard to specified categories is not apparent, and can lead to undesirable rigidity. The inquiry is a straightforward question of fact, which does not require either the substitution of other words or the application of a formula."
[301] *Cowan de Groot Properties Ltd v Eagle Trust plc* [1991] BCLC 1045, 1111 (Knox J).
[302] *Air Canada v M & L Travel Ltd* [1993] 3 SCR 787, 812 (Iacobucci J).
[303] *Barret v McCormack* (1999) 4 ITELR 1, 32 (per curiam).

has participated in a money laundering operation, it is relevant to ask whether he knew that the purpose of the transactions in which he participated was to conceal the origins of the funds which passed through his hands.[304] If he has enabled the primary wrongdoer to place trust funds in the wrongdoer's bank account, it is relevant to ask whether he knew that the account was in credit and that the wrongdoer intended to pay the beneficiaries without delay, or whether he knew that the account was overdrawn and that the wrongdoer intended to use the money for its own purposes.[305] In other cases, other matters will be relevant.

Having made this fairly obvious point, the more difficult question remains whether there is anything which *all* dishonest assistants must have known before they can be fixed with liability. More specifically, the question remains whether a defendant must have known that his actions or omissions would enable a wrong to be committed against the claimant, or whether it is sufficient that he knew his actions or omissions would enable a wrong to be committed against some person or persons unknown, or even that he thought (incorrectly) that they would enable a wrong to be committed against some particular person who was not the claimant. If we find that a defendant must have known of a wrong against the claimant, we must also ask whether he must have identified that wrong specifically as a breach of trust or fiduciary duty.

Some light is thrown on these questions by Morison J's finding in *Ferrotex Industrial Ltd v Banque Français de l'Orient*,[306] that it is not enough for a bank to have known that its client had been dishonest in its dealings with the bank, and that carrying out his instructions would both cause loss to a third party and redound to the bank's own benefit. Also relevant is *The Bank v A Ltd*,[307] where Laddie J held (perhaps surprisingly) that a bank could "never" be said to have acted dishonestly by operating its customer's account, where the customer had deposited around US $1.2 million within weeks of opening the account, and the bank had been told by the Metropolitan Police that it was investigating the customer in relation to certain suspected financial frauds. In Laddie J's view, "all [the bank] had were suspicions," and failing to act on these by refusing to operate the account would not have constituted dishonest behaviour:[308]

> at its highest, the intelligence passed to the bank [by the police] should have made it suspicious that A Ltd and some of its backers may have been involved or might become involved in some types of wrongdoing.

[304] *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 526 (Nourse LJ).
[305] *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 251 and 255 (Huband JA).
[306] QBD (Comm Ct) 4 July 2000, paras 36–7.
[307] [2000] Lloyd's Rep Bank 271, aff'd on a different point *sub nom Bank of Scotland v A Ltd* [2001] 1 WLR 751.
[308] *The Bank v A Ltd* (n 307 above) 283. Cf *Wavefront Trading Ltd v Po Sang Bank Ltd* [1999] HKCFI 5 (Keith J): "Refusing to comply with a customer's instructions is an extreme step, not to be taken lightly by a bank. . . . banks should not be expected to freeze a customer's account merely on notice that someone was making a claim against the customer's money in the account."

More immediately, though, we must consider Millett J's statement in *Agip (Africa) Ltd v Jackson*,[309] that it would suffice for a finding of dishonesty that the defendants had known that they were participating in a fraud, and that it made no difference whether they knew the identity of their victim. He held that:[310]

> It is no defence for a man charged with having knowingly assisted in a fraudulent and dishonest scheme to say that he thought it was "only" a breach of exchange control or "only" a case of tax evasion. It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of its victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party, takes the risk that they are part of a fraud practised on that party.

This statement marked a departure from Sachs LJ's previous statement in *Carl Zeiss Stiftung v Herbert Smith & Co (No 2)*, that a defendant must have had "both actual knowledge of the trust's existence and actual knowledge that what is being done is improperly in breach of that trust."[311] But in *Brinks Ltd v Abu-Saleh (No 3)*,[312] a case which has been discussed above,[313] Rimer J then stated that even if the defendant had relevantly assisted her husband in a breach of trust (which he held that she had not), he would not have held that she had possessed the requisite state of mind for liability. For although she had known that her husband's trips were for the purpose of carrying large sums of cash out of the country, she had thought that he was undertaking them for the purposes of tax evasion, and in Rimer J's view, this was not enough.

The inconsistency between the *Agip* case and the *Brinks* case has since been discussed by Mance LJ (sitting as a judge at first instance), and by the Court of Appeal, in *Grupo Torras SA v Al-Sabah (No 5)*.[314] In Mance LJ's view, Millett J's comments were deprived of general authority by the fact that in *Agip* the

[309] [1990] 1 Ch 265.
[310] *Agip (Africa) Ltd v Jackson* (n 309 above) 295, followed in *Barret v McCormack* (1999) 4 ITELR 1 26 (per curiam), and again in *Banque Nationale de Paris v Hew* [2001] 1 SLR 300, 333–4 (Lai Kew Chai J). See too Fox LJ's comment in the Court of Appeal in the *Agip* case [1991] Ch 547, 569: "I do not think that persons who needed to demonstrate that they had acted honestly could shelter behind transactions or objects which were themselves disreputable."
[311] [1969] 2 All ER 367, 379, cited with approval in *Air Canada v M & L Travel Ltd* [1993] 3 SCR 787, 811–2 (Iacobucci J), and recently followed in *Sorrel 1985 Limited Partnership v Sorrel Resources Ltd* [2001] 1 WWR 93, 105 (Picard JA). See too *Baden, Delvaux* (n 8 above) 575 (Peter Gibson J): the defendant "must know that there was a trust"; but cf *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* [1998] 2 NZLR 481, 639 (Smellie J), holding that "it is not necessary for [a dishonest assistant] . . . to know all the details of the trust. It is sufficient if s/he knows the property is subject to a trust."
[312] The Times 23 October 1995. Cf *National Mutual Property Services (Australia) Pty Ltd v Citibank Services Ltd* (Fed Ct of Aus 28 May 1998) where Lindgren J considered that a defendant "must have actually known all the circumstances constituting the elements of the breach of fiduciary duty," while conceding that "there has been some difference of opinion . . . as to the nature and extent of the awareness required of the [defendant], and, therefore, on the issue of the [defendant's] 'fault' or 'blameworthiness.'"
[313] In part C, section (3)(b).
[314] QBD (Comm Ct), 24 June 1999; on appeal: [2001] Lloyd's Rep Bank 36.

defendants had in fact had ample reason to suspect a fraud on the claimant,[315] and he preferred Rimer J's approach:

> The problem with which Rimer J was concerned was the not uncommon problem that, if she had assisted at all, the defendant [in the *Brinks* case] would plainly have been dishonest in a general sense, since it was clear that the whole purpose of the trips was dishonest tax evasion. But the answer to this problem seems to lie in recognising that, for dishonest assistance, the defendant's dishonesty must have been towards the plaintiff in relation to property held or potentially held on trust or constructive trust, rather than in the introduction of a separate criterion of knowledge of any such trust.

On appeal, the Court of Appeal did not find it necessary to express a final view on this point, as on the facts of the *Grupo Torras* case, the appellant for whom it might have made a difference had known that the funds with which he had been concerned had belonged to, or emanated from, the claimants.[316] Nonetheless, their Lordships stated that they were "disposed to agree with Rimer J's observations."[317]

Notwithstanding these dicta, it is hard to agree that a defendant who knows or has good grounds for suspecting that he has assisted in fraudulent behaviour of some kind should be absolved from liability towards the claimant he has actually helped to defraud, because he did not know who his victim was, or because he thought he was defrauding someone else. To allow a defendant to rely on this argument is effectively to absolve him from liability on the ground that he assumed the risk that someone other than the actual victim of his wrongdoing might pursue him through the civil—or criminal—justice system, but that he did not assume the risk that the actual victims of his wrongdoing should do so. It is hard to see why someone who has acted dishonestly should be allowed to rely on this morally disreputable argument. Moreover, the practical effect of the Court of Appeal's dictum is to make it easier for defendants to escape liability for dishonest assistance by fabricating explanations of their behaviour: an untruthful story of dishonest conspiracy is often likelier to correspond with the facts of a dishonest assistance case than an untruthful story of blameless conduct.

Finally in this sub-section, we may note that in *Twinsectra Ltd v Yardley*,[318] the defendant solicitor, Leach, sought to evade liability for dishonest assistance by arguing that the "question whether [he had] . . . acted dishonestly in the Nelsonian sense depend[ed] on whether he [had] appreciated that what [had been] anticipated [had been] a 'mere' breach of undertaking or that it [had] constituted a breach of trust."[319] But Potter LJ was having none of this:[320]

[315] They had also refused to testify, with the consequences set out in the text to n 279 above.
[316] *Grupo Torras* [2001] Lloyds Rep Bank 36, 59 (per curiam).
[317] *Grupo Torras* [2001] Lloyds Rep Bank 36, 59 (per curiam).
[318] [1999] Lloyd's Rep Bank 438.
[319] *Twinsectra Ltd v Yardley* (n 318 above) 465–6.
[320] *Twinsectra Ltd v Yardley* (n 318 above) 466.

In such a case the vice seems to me to rest in deliberately closing his eyes to the rights of Twinsectra, whether legal or equitable, as the beneficiary of the undertaking . . .

In other words, Potter LJ considered that liability for dishonest assistance can be incurred by those who know that they are assisting in a wrong of some sort directed against a particular claimant, even if they are unaware of that wrong's legal categorization. This approach was consistent with the decision of the Court of Appeal in *Belmont Finance Corp v Williams Furniture Ltd (No 2)*, that it is sufficient for the purposes of a tort claim for civil conspiracy that the defendant knew that his actions were wrongful, even if he did not appreciate their precise legal significance.[321] It is also consistent with various cases from Australia, Canada, and New Zealand, suggesting that a stranger need only know the underlying facts, and need not know the legal principles which impose a fiduciary duty on the trustee, to be fixed with recipient or accessory liability for breach of trust.[322]

Against this line of authorities, however, we may place the finding of the New South Wales Court of Appeal in *United States Surgical Corp v Hospital Products International Pty Ltd*,[323] that an assistant must not only have known the facts which gave rise to the primary breach but must also have recognized that on such facts a primary breach must have been committed as a matter of law. We may also note that the Canadian courts have declined to find defendants liable for knowing assistance in cases concerning breaches of ("remedial") constructive trusts, as opposed to express trusts, where it has been unpredictable whether a court would exercise its discretion to discover a constructive trust to

321 [1980] 1 All ER 393, 404–5 (Buckley LJ, adopting Viscount Dilhorne's remarks to the same effect in relation to criminal conspiracy, in *Churchill v Walton* [1967] 2 AC 224, 237): "If all the facts which make the transaction unlawful were known to the parties . . . ignorance of the law will not excuse them. . . . Nor . . . can the fact that their ignorance of, or failure to appreciate, the unlawful nature of the transaction was due to the unfortunate fact that they were . . . erroneously advised excuse them." See too *Maguire v City of Calgary* (1983) 146 DLR (3d) 350, 354 (per curiam).

322 *Coy v Pommerenke* (1911) 44 SCR 543; *Canada Safeway Ltd v Thompson* [1951] 3 DLR 295; *Gathergood v Blundell & Brown Ltd* [1992] 3 NZLR 643, 646 (Cooke P), 648 (Gault J), and 650 (McKay J); *Hanson v Clifford* (1994) 59 CPR (3d) 465, 502 (Errico J); *Hunters Products Group Ltd (in liq) v Kindly Products Pty Ltd* (1996) 20 ACSR 412, 431–2 (Nathan J), equating "moral obtuseness" with ignorance of the law, and finding that it was enough to fix the defendant bank with liability for aiding and abetting a breach of the Victoria Companies Code, s 129, that it was "knowingly concerned in the grant of assistance" and that there was no need to prove that it was "knowingly concerned in a breach of the section." See too *Air Canada v M & L Travel Ltd* [1993] 3 SCR 787, 812 (Iacobucci J), holding that "if the trust was imposed by statute, then [the 'knowing assistant'] . . . will be deemed to have known of it," a ruling that has been followed in various Canadian cases concerned with breaches of builders' lien statutes, eg, *St Mary's Cement Corp v Construc Ltd* (1997) 32 OR (3d) 595; *Glenko Enterprises Ltd v Keller* [2001] 1 WWR 229, 249 (Huband JA). See too *Bare Land Condominium Plan 8820814 v Birchwood Village Greens Ltd* (Alberta QB 30 November 1998) para 64 (Nation J) (this case concerned the misapplication of statutory holdbacks in the course of a condominium development project).

323 [1983] 2 NSWLR 157, 253. See too *Ninety Five Pty Ltd v Banque Nationale de Paris* [1988] WAR 132, 176 (Smith J), holding that knowledge of the law might be needed where no trust property ever passed through an assistant's hands.

have arisen on the facts.[324] By the same token, one might wonder whether Leach was not rather harshly treated in the *Twinsectra* case, given that he had had no means of knowing that a court would later hold that the breach of contract in which he thought he had assisted had in fact been a breach of a *Quistclose* trust. But on the other hand there is no obvious reason why we should distinguish between the exercise of strong and weak discretions by the courts when they come to determine whether a primary wrong has been committed: ie, if a defendant can be held liable for dishonestly assisting in a primary breach discovered by a court in the course of exercising its fact-finding function, why should he not also be liable for dishonestly assisting in a breach which a court discovers in the course of exercising its discretionary powers to award legal remedies? At the time of writing, an appeal to the House of Lords in the *Twinsectra* case is pending: it will be interesting to see whether their Lordships make anything of this aspect of the case.

### *(e) Knowledge When?*

"Since it is the assistance which must be dishonest [for the purposes of a claim in dishonest assistance], it is [the defendant's] state of knowledge at the time the [relevant] dealings were carried out that is material."[325] Hence, "while it is tempting to look back at [the assistant's] state of mind when all the facts are known and the overall picture has emerged," this temptation must be resisted, and the court must instead "look at [the assistant's state of mind] at the time of the transactions in question and in the light of the facts then known to her."[326] Nor can a defendant be fixed with knowledge retrospectively where he has acted with an

[324] *Constantine v Ioan (Irons) and Chase* (1969) 67 WWR 615, 624 (Gould J): "I decline to fix Chase with advance knowledge in 1966 that a judge was going to decide in 1969, after a two-day trial, that Irons was a constructive trustee for Constantine as to an unascertained portion of the assets in the bank"; *Besta International Corp v Watercraft Offshore Canada Ltd* (British Columbia Sup Ct 14 December 1994) paras 34–5 (Saunders J): "In this case, the trust flowed not from express terms in a document, or from a statute, but rather from operation of the rules of equity . . . the existence of the trust was not self-evident and required the decision of the court"; *Durish v White Resource Management Ltd* [1998] ABQB 801, para 232 (Mason J); *Gordon v Winnipeg Canoe Club* (1999) 172 DLR (4th) 423, 436 (Huband JA): "It is one thing to be aware of an express trust and the circumstances under which a breach of that trust occurs. It is quite another matter to discern a constructive trust situation, which no court has yet declared, and where the circumstances to support a subsequent declaration of trust are far from clear. In the present case, until such time as the court declared the insurance proceeds to be subject to a trust, I do not see how the defendant Stewart and the other personal defendants could be said to have knowledge of the breach of trust." But cf *Transamerica Occidental Life Insurance Co v Toronto Dominion Bank* (1999) 173 DLR (4th) 468, 489 (Osborne JA): "[The appellant] must establish that [the respondent] can, in law, assist in a breach of a constructive trust on the basis of actions that took place before the constructive trust was declared to exist. This aspect of the case requires an inquiry into [the respondent's] knowledge of the underlying facts . . . [which were not in issue on the motion]."

[325] *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 523–4 (Nourse LJ), followed in *Royal Westmoreland v Skene* (QBD 7 November 2000).

[326] *Lurgi (Australia) Pty Ltd v Gratz* [2000] VSC 278, para 69 (Byrne J). Cf *Bell Group Ltd (in liq) v Westpac Banking Corp* [2001] WASC 315, para 175 (Owen J).

innocent state of mind but has later become aware of facts revealing that these actions enabled the commission of a primary breach of duty. So, in a Canadian case, *Northland Bank v Willson*,[327] where a defendant participated in a series of transactions which enabled the officials of the claimant bank to misapply the bank's money in breach of fiduciary duty, and he only become fully aware of the facts indicating the wrongful nature of these transactions after several of them had already been carried through, he was not liable for dishonest assistance in respect of these early transactions. He was liable, however, for the later transactions in which he had participated with full knowledge of their wrongful nature. In so holding, Wilkins J also decided that "to the extent that [the evidence relied upon by the bank's liquidator] creates an ambiguity on the issue of timing . . . the ambiguity must be resolved in favour of the [defendant]."[328]

### *(f) Knowledge and Artificial Personality*

Liability for dishonest assistance depends upon proof of a dishonest state of mind. Artificial persons such as companies do not have a brain and so do not have a mind. There are three ways in which the courts could have responded to these facts. First, they could have held that it is meaningless to speak of an artificial person possessing a dishonest state of mind, that liability for dishonest assistance therefore cannot be incurred by artificial persons, and that the victims of breaches of equitable duty in which artificial persons have participated can therefore have no remedy against them as dishonest assistants. Secondly, they could have held that the rules governing liability for dishonest assistance are inaptly framed for artificial persons, that it is nonetheless desirable in that they should sometimes be held to account for participating in breaches of equitable duty, and that a different, apter set of rules for this purpose should therefore be created. Or, thirdly, they could have held that artificial persons might be brought within the ambit of the rules governing liability for dishonest assistance notwithstanding the inaptness of these rules for artificial persons, by fictionally deeming an artificial person to have possessed a requisite state of mind in appropriate circumstances. In the event, the courts chose the third option, and in appropriate circumstances artificial persons such as companies can therefore be fictionally deemed to have possessed a relevant state of mind for the purposes of dishonest assistance claims, in accordance with the "special" rules of attribution discussed by Lord Hoffmann in *Meridian Global Funds Management Asia Ltd v Securities Commission*.[329]

[327] (1999) 249 AR 201, 235 and 237 (Wilkins J). Cf *Ghana Commercial Bank v C* The Times 3 March 1997: recipients of stolen money would become personally liable to the owner "as constructive trustees" once they had knowledge of the owner's claim, but would owe no personal liability in respect of the period between the moment of receipt and the moment of knowledge.

[328] *Northland Bank v Willson* (n 327 above) 235.

[329] [1995] 2 AC 500, 507. See section (3)(c) above.

These rules work by fictionally deeming an artificial person to have had a mind whose knowledge and thought processes are "identified" with those of a particular human individual: in the context of dishonest assistance claims, the artificial person is deemed to have possessed a dishonest state of mind if the human being with whom it was identified possessed a dishonest state of mind. Much therefore turns on which human individuals should be identified with the artificial person for this purpose. In line with Lord Hoffmann's observations on this point in the *Meridian* case, the answer to this question will turn on several factors, including the nature of dishonest assistance liability, the policy reasons for which such liability is imposed, and the roles and responsibilities of those human individuals who have acted for the artificial person in the relevant transaction. Thus, for example, in *Nightingale Finance Ltd v Scott*,[330] Carnwath J held that although a company's mind should prima facie have been identified with the mind of its officer who had signed the documents for the company which had enabled a fraud to be committed against a third party, this officer had:

> signed the consents without paying any attention at all to what he was signing. . . . [It] seems to follow that [he] was implicitly delegating to [a second director who had asked him to sign them] the executive responsibility for the consents. It would then become wholly correct to say that . . . [this second director's] knowledge, relevant to the consents, can be attributed to the company, and, that if he was dishonest in giving those consents, then so was the company.[331]

The *Meridian* case was a significant step forward for the law relating to the identification doctrine, as it required the courts to analyse attribution issues in a more context-specific manner than they had previously managed. One problem that remains, however, is that Lord Hoffmann's analysis was premised on the understanding that an artificial person can only be identified with particular human individuals, and he did not contemplate that an artificial person might be deemed to possess a "composite state of mind" formed out of the aggregated

[330] Ch D 18 November 1997. See too *BTR Engineering (Australia) Ltd v Patterson* (NSW Sup Ct 20 June 1991); *Humphris v Jenshol* (1997) 25 ACSR 212; *Andic International Pty Ltd v FSM Wytwornia Wyrobow Roznych SA* (NSW Sup Ct (Command Eq Divs) 17 March 1988); *Royal Westmoreland v Skene* (QBD 7 November 2000); *Ikeuchi v Liu* [2001] QSC 54, para 144 (Muir J); *Capital Investments Corp Pty Ltd v Classic Trading Pty Ltd* [2001] FCA 1385. And cf *Canson Enterprises Ltd v Boughton & Co* [1996] 1 WWR 412, 427 (Rowles JA), holding that the defendant law firm could not be liable for knowing assistance because the member of the firm who had had actual knowledge of the breach (Boughton) had not been the member of the firm who had carried out the assisting transaction (Wollen), and if Boughton's knowledge were imputed to Wollen then the most that could be said of Wollen was that he had had possessed constructive knowledge, which was not enough for liability as a knowing assistant. This reasoning will do to explain why Wollen was not himself liable as a knowing assistant, but it overlooks the point that *the firm* might have been fixed with Boughton's actual knowledge, and so found liable: P M Perrell "Compensation and the Scope of Equity's Remedial and Restitutionary Generosity" (1999) 37 Alberta LR 114, 128–9.

[331] Carnwath J expresses the same conclusion in a passage omitted from the quoted text, when he states that [Wharton] was "the directing mind of the company" in relation to the giving of those consents. With respect, though, this way of putting the matter seems a confusing throwback to the pre-*Meridian* law, under which it was presumed that a company's directors were the only human individuals with whom it could be identified.

knowledge and viewpoints of several different human beings. The argument that this should be possible in principle is probably stronger where it is sought to fix an artificial person with liability for negligent omissions rather than dishonest actions, but under English law aggregation cannot currently be used to fix an artificial person with either type of liability. It was expressly rejected in the context of criminal proceedings against companies for manslaughter, in *R v HM Coroner for East Kent, ex parte Spooner*,[332] and *A-G's Reference (No 2 of 1999)*,[333] and the Law Commission has also opposed the idea in two of its recent reports: *Fiduciary Rules and Regulatory Rules*[334] and *Legislating the Criminal Code—Involuntary Manslaughter*.[335]

In contrast, some Australian courts have shown themselves sympathetic to the idea of aggregation in the context of dishonest assistance claims. For example, the Victoria Court of Appeal in *Macquarie Bank Ltd v Sixty-Fourth Throne Pty Ltd*[336] had to consider the import of the statement previously made by the High Court of Australia in *Krakowski v Eurolynx Properties Ltd*,[337] that "a division of function among officers of a corporation responsible for different aspects of the one transaction does not relieve the corporation from responsibility determined by reference to the knowledge possessed by each of them." Tadgell JA refused to accept that this passage "justifies the simple aggregation of the knowledge of a number of persons individually unaware of fraud, or facts which ought to disclose it, to create a notional person with dishonest intent." But Ashley AJA took a different line. He thought it was:[338]

> somewhat unsatisfactory that the state of mind of [a person whose mind is deemed to have been the company's mind for the purposes of the identification doctrine] should be considered apart from any knowledge of circumstances which ought to have been but was not conveyed to that person by another servant or agent of the company. That would leave the way open, potentially, for a company to benefit from a failure to communicate knowledge in circumstances where there should have been such communication.

This led him to think that there was "a good deal to commend the approach" suggested by Wooten J in *Re Chisum Services Pty Ltd*,[339] that aggregation of knowledge should be permitted where individual employees of a company were under a duty, and had the opportunity, to share information with one another—whether or not this duty was complied with and this opportunity taken. On the facts of the *Sixty-Fourth Throne* case, however, this approach did not advantage the

[332] (1989) 88 Cr App R 10, 15–17 (Bingham LJ). See too *R v P & O European Ferries (Dover) Ltd* (1991) 93 Cr App R 72, 84 (Turner J).
[333] [2000] 3 WLR 195, 211–212 (per curiam).
[334] Law Com No 236 (1995), para 12.6.
[335] Law Com No 237 (1996), para 7.32.
[336] [1998] 3 VR 133.
[337] (1995) 183 CLR 563, 582–3 (Brennan, Deane, Gaudron, and McHugh JJ), citing *Dunlop v Woollahra MC* [1975] 2 NSWLR 446, 485 (Wootten J), and *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153, 170 (Lord Reid).
[338] *Macquarie Bank* (n 336 above) 161.
[339] (1982) 7 ACLR 641, 650.

claimant, as it had "failed to identify any person whose mind should be taken to have been the mind of [the defendant company], in respect of whom an obligation to convey pertinent information (there being an opportunity to convey that information) was imposed upon other servants of the company."

Aggregation of knowledge also commended itself to Smellie J in *Equiticorp Industries Group Ltd (in stat man) v R (No 47)*,[340] a well known New Zealand case that took up around two hundred trial days in 1994 and 1995. Without discussing all the complex facts of this case, it is enough for present purposes to say that Smellie J relied on the Australian cases already noted to hold that the sum of the knowledge possessed by various civil servants in the employment of the New Zealand government and by various of the government's legal and financial advisers could be "aggregated to make up a composite whole . . . [a] total pool of knowledge residing in the Crown by which its position as an alleged dishonest assister [*sic*] or knowing recipient can be judged."[341]

### *(g) Dishonesty and Personal Accomplishment*

Lord Nicholls made it clear in the *Royal Brunei* case that a defendant is not entitled to have the morality of his behaviour judged against his personal moral standards, rather than the standards of society,[342] but he also considered that attention might be paid to some of the defendant's personal attributes such as his experience and intelligence when deciding whether he has acted dishonestly.[343] It follows that an inexperienced and foolish defendant can argue that he has not acted dishonestly because he failed to appreciate that he should have acted differently, even though a person of greater experience and intelligence would not have made the same mistake.[344] Obviously, a court may disbelieve that a defendant relying on this argument is as stupid as he makes out, and legal and financial professionals (who we may remind ourselves are very often the defendants in

[340] [1998] 2 NZLR 481.

[341] *Equiticorp Industries Group Ltd (in stat man) v R (No 47)* (n 340 above) 627–9.

[342] *Royal Brunei Airlines Sdn Bhd v Tan* (n 1 above) 389: "honesty is not an optional scale, with higher or lower values according to the moral standards of each individual." See too *Aktieselskabet Dansk Skibsfinansiering v Brothers* [2001] 2 BCLC 324, 334 (Lord Hoffmann, sitting as a judge of the Hong Kong Court of Final Appeal): "a defendant cannot be allowed to shelter behind some private standard of honesty not shared by the community."

[343] *Royal Brunei Airlines Sdn Bhd v Tan* (n 1 above) 391.

[344] As in eg, *BTR Engineering (Australia) Ltd v Patterson* (NSW Sup Ct (Comm Div) 20 June 1991) (Giles J): "At first sight it is strange that Mrs Patterson would not have exercised some curiosity whereby she gained at least a rudimentary understanding that Mr Patterson's business ventures were hard to reconcile with the income of a salaried employee. But I accept what Mrs Patterson said. It became clear, in my view, that she really had no idea of the transactions to which she was nominally a party, either personally or as director of a company, and that she did not exercise her mind in relation to the transactions." See too *Banque Nationale de Paris v Hew* [2001] 1 SLR 300, 333 (Lai Kew Chai J): if a defendant "is driven by ties of kinship, compassion, altruism or an exaggeratedly credulous or trusting nature or disposition, I do not think that such traits or shortcomings, however lamentable, amount to dishonesty in the context of accessory liability."

dishonest assistance claims) are generally less likely than others to persuade a court of their ineptitude,[345] although they sometimes succeed in doing so.[346]

In practice, it can be difficult to distinguish the morally from the intellectually challenged,[347] and with respect, this problem has not been resolved by Sir Christopher Slade's remarks on this subject in *Walker v Stones*.[348] Here, the Court of Appeal had to decide whether a defendant trustee fell within the scope of an exemption clause in a trust deed on the basis that he had acted honestly. The point arose, whether a trustee who knowingly commits a breach of trust can be said to have acted honestly if he sincerely believes this to be in the beneficiaries' best interests, and in the course of determining this question, Sir Christopher sought to reconcile Lord Nicholls' understanding of dishonesty in the *Royal Brunei* case with Millett LJ's view in *Armitage v Nurse*,[349] that trustees who deliberately commit a breach of trust by "consciously acting beyond their powers (as, for example, by making an investment which they know to be unauthorized)" do not act fraudulently if they act "in good faith and in the honest belief that they are acting in the interest of the beneficiaries." Sir Christopher could see:[350]

[345] Cf *Houghton v Fayers* [2000] Lloyd's Rep Bank 145, 151 (Buxton LJ): "Mr Day, as a man who claims to act as a consultant in financial and insolvency matters, could hardly be unaware of the importance of [the corporate structure of a company from which money was misappropriated] in relation to his belief as to the propriety of all the payments made"; in subsequent proceedings, Day was found on the facts to have acted dishonestly: *Fayers Legal Services Ltd v Day* (Ch D 11 April 2001). See too *Re a Solicitor* (QBD (Div Ct) 20 November 2000) para 26 (Hallett J): "It will be a rare case indeed in which a solicitor could argue successfully that what may have been obviously dishonest to an ordinary member of the public was not obviously dishonest to him".

[346] As in eg, *Thomas v Pearce* (CA 10 February 2000) (which concerned an estate agent). And cf *Mortgage Express Ltd v S Newman & Co (a firm)* [2000] PNLR 298, 322 (Hart J): "It is unfortunately the case that very many solicitors at this period [*sc*: the late 1980s and early 1990s] (which was well before the type of mortgage fraud practised here had achieved wide notoriety) appear to have laboured under the assumption that their duties to mortgagees were of a very restricted nature and to have been almost incredibly naive as to the nature of the problems to which they were exposing themselves. My conclusion is that [the defendant's solicitor's] whole approach to this problem was from the outset both naive and well below the standards which should be expected of her profession, but was not dishonest." On appeal, it was held that Hart J had improperly reached this conclusion on the basis of facts which were not properly admitted in evidence, and the case was returned for a retrial: [2001] PNLR 86. The claim by Mortgage Express was then settled, but the defendant was later found to have acted honestly in third party proceedings brought by the defendant against the Solicitors' Indemnity Fund: Ch D 1 March 2001. The Law Society first issued a Green Card warning on mortgage fraud to its members in March 1991, listing signs to watch out for, including unusual transactions, unusual instructions, incomplete documentation, and changes in the purchase price.

[347] Cf *Mortgage Express Ltd v S Newman & Co (a firm)* (Ch D 1 March 2001) para 9 (Etherton J), referring to "the legal difficulties at the interface between dishonesty and incompetence at the extreme end of the range of competent conduct."

[348] [2001] QB 902.

[349] [1998] Ch 241, 250–251, repeated by Lord Millett in *Three Rivers DC v Governor and Company of the Bank of England (No 3)* [2000] 2 WLR 1220, 1274: "a deliberate breach of trust is not dishonest if it is committed by the trustee in good faith and in the honest belief that it is for the benefit of those in whose interests he is bound to act."

[350] *Walker v Stones* (above n 348) 941. Cf *Northland Bank v Willson* (1999) 249 AR 201, 225 (Wilkins J): "It is not open to [bank officers who laid out the bank's money in a scheme designed to create the false impression that it had larger assets than was in fact the case] to ask the court to

no grounds for applying a different test of honesty in the context of a trustee exemption clause . . . from that applicable to the liability of an accessory in a breach of trust. It would be surprising if the court in *Armitage* had regarded itself as differing from *Tan* without saying so or explaining why. I think that . . . in saying that if trustees deliberately commit a breach of trust they are not dishonest provided that "they do so in good faith and in the honest belief that they are acting in the interests of the beneficiaries" . . . Millett LJ was directing his mind to the not uncommon case of what Selwyn LJ had once described as "judicious breaches of trust".[351] I think it most unlikely that he would have intended this dictum to apply in a case where a solicitor-trustee's perception of the interests of the beneficiaries was so unreasonable that no reasonable solicitor-trustee could have held such a belief.

It seems to follow from these remarks that a defendant who deliberately assists in a breach of equitable duty, in the mistaken but sincerely held belief that this is in the best interests of the beneficiaries, is not dishonest unless his belief is an "unreasonable" one. But this conclusion is unsatisfactory. The *Royal Brunei* case makes it clear that the courts should not judge the morality of a defendant's behaviour by reference to his intellectual ability, but should rather judge it by reference to the moral standards of society. Dishonesty is not the same thing as stupidity. Liability for dishonest assistance turns on a finding that the defendant, knowing what he knew, and appreciating the implications of that information as best he might, acted in a way that an honest person with the same information and the same level of understanding would have baulked at. It is not to the point that a more intelligent person than the defendant would have made a better job of interpreting the situation and the moral conundrums which it presented.[352]

The same objection might be made to Potter LJ's view in *Twinsectra Ltd v Yardley*,[353] that the defendant could have rebutted an allegation of dishonesty by relying on some:[354]

particular circumstance, characteristic or lack of experience . . . to suggest that the standard of honesty to be expected of him was other than that to be expected of the *reasonably prudent* and honest solicitor.

condone their deception on the basis that they received no personal gain from it or that these steps were taken only to preserve the continued viability of the bank. It cannot be said that the best interest of the bank is necessarily its continued operation when that operation can only be maintained by fraud and deceit practised against its shareholders, auditors, regulators, and all persons who deal with the bank in reliance on the truth of its financial records."

351 A reference to *Perrins v Bellamy* [1899] 1 Ch 797, 798 (Lindley MR): "My old master, the late Selwyn LJ, used to say 'The main duty of a trustee is to commit judicious breaches of trust.'"

352 Cf *Mortgage Express Ltd v S Newman & Co (a firm)* (Ch D 1 March 2001) para 7 (Etherton J): "I do not consider that Sir Christopher Slade could have been intending . . . to abolish the critical distinction between incompetence and dishonesty . . . Incompetence, even gross incompetence, does not amount to dishonesty, without more."

353 [1999] Lloyd's Rep Bank 438.

354 *Twinsectra Ltd v Yardley* (n 353 above) 465. My emphasis. In the *Mortgage Express* case (n 352 above) para 8, Etherton J construed Potter LJ's reference to "a reasonably prudent and honest solicitor" as "a reference to the fact that the solicitor trustee under scrutiny in *Twinsectra* was such a person and could not and did not plead lack of experience as a ground for his actions."

And indeed, an objection of this sort was raised to Mance LJ's findings in *Grupo Torras SA v Al-Sabah (No 5)*,[355] that one of the appellants, a lawyer named Folchi, had acted dishonestly. Folchi submitted that:[356]

The judge applied an entirely objective test and expressed his conclusions in terms of negligence rather than dishonesty. Applying the *Royal Brunei* test a person can only be found objectively dishonest where his standard of honesty is lower than an objective standard . . . The judge made no such finding against Mr Folchi. . . .One finding he could have made was that Mr Folchi, suspecting the propriety of the transactions in question, deliberately closed his eyes and ears or deliberately did not ask questions about them—so called "blind eye" dishonesty. But no such finding was made by the judge who expressed his conclusions in terms of what an honest lawyer would do rather than what Mr Folchi actually did. In other words he wrongly applied an objective test attributing constructive or imputed knowledge to Mr Folchi. Such knowledge cannot give rise to a finding of dishonesty.

The Court of Appeal were caused "considerable concern" by these submissions,[357] but upheld Mance LJ's finding of dishonesty on the basis that various statements in his judgment supported the view that he had meant to hold that Folchi had consciously turned a blind eye to the fraudulent nature of the transactions in which he had participated. At the same time, their Lordships stressed that:[358]

In these cases, as with any other case where a finding of dishonesty is made, the judge should make the basis for his finding crystal clear. If he is finding objective dishonesty, properly so called, he should say so making it clear that, although/even if he accepted that the defendant believed that he was doing nothing wrong, he was nevertheless dishonest by objective standards.

The final word in this sub-section may go to Lord Hoffmann, who recently returned to a favourite theme,[359] when he warned against employing the concept of "the hypothetical decent honest man" to encapsulate the notion of objective dishonesty:[360]

The danger is that because decent honest people also tend to behave reasonably, considerately and so forth, there may be a temptation to treat shortcomings in these respects as a failure to comply with the necessary objective standard. It seems to me much safer, at least in the context of an allegation of fraud, to concentrate upon the actual defendants

[355] QBD (Comm Ct) 24 June 1999; on appeal: [2001] Lloyd's Rep Bank 36.
[356] *Grupo Torras SA v Al-Sabah* (n 355 above) 60 (per curiam).
[357] *Grupo Torras SA v Al-Sabah* (n 355 above) 60 (per curiam).
[358] *Grupo Torras SA v Al-Sabah* (n 355 above) 61 (per curiam). Cf *Twinsectra Ltd v Yardley* [1999] Lloyd's Rep Bank 438, 462 (Potter LJ), having to clarify Carnwath J's finding at first instance that the defendant "was not dishonest, but that he did deliberately shut his eyes to the implications of the undertaking."
[359] Cf *Re Saul D Harrison & Sons plc* [1995] 1 BCLC 14, 17 (Hoffmann LJ): "In explaining how the courts set about deciding what is fair in the context of company management, I do not think it helps a great deal to add the reasonable company watcher to the already substantial cast of imaginary characters which the law uses to personify its standards of justice in different situations."
[360] *Aktieselskabet Dansk Skibsfinansiering v Brothers* [2001] 2 BCLC 324, 334 (Lord Hoffmann, sitting as a judge of the Hong Kong Court of Final Appeal).

and simply ask whether they have been dishonest. Judges and juries seldom have any conceptual difficulty in knowing what is meant by dishonesty.

## D DEFENCES

### 1 Release

If a claimant executes a formal release from liability in favour of a dishonest assistant, or expressly affirms the validity of the transaction in which the dishonest assistant has participated, then the claimant will generally be unable to sue the dishonest assistant afterwards. Exceptionally, though, where a defendant has dishonestly assisted in a breach of fiduciary duty committed by company directors which results in the company's insolvency, and the defendant's actions are purportedly ratified by the company's only shareholders who are themselves parties to the primary breach, their purported ratification may be ineffective to absolve the defendant from a claim by the liquidator in the company's name for the benefit of the company's creditors.[361]

If a claimant releases the primary wrongdoer or affirms or acquiesces in the primary breach of duty, then this too will debar him from suing the dishonest assistant. The reason for this is that dishonest assistants are jointly and severally liable with the wrongdoing trustees or fiduciaries in whose breaches of duty they assist,[362] with the consequence that the release of one operates to release the others as well.[363] It should be borne in mind, though, that there is a distinction between a release from liability, and a covenant not to sue, and that a claimant who merely covenants not to sue the primary wrongdoer, while preserving his

[361] *Re Gasbourne Pty Ltd* [1984] VR 801, 839 (Nicholson J). This dictum seems consistent with a series of recent cases holding that the rule in *Re Duomatic Ltd* [1969] 2 Ch 365 does not permit the ratification of a breach of duty owed to a company by the unanimous informal assent of the shareholders, if the purpose of the rule imposing the duty is to protect other interest groups besides the shareholders as a whole: *Wright v Atlas Wright (Europe) Ltd* [1999] 2 BCLC 301; *Re Torvale Group Ltd* [1999] 2 BCLC 605; *BDG Roof Bond Ltd v Douglas* [2000] 1 BCLC 401.

[362] See the cases cited above n 94.

[363] Cf G Williams, *Joint Obligations* (Butterworths London 1949)160, noting that "the several part of [a] joint and several liability is not a cumulative several liability but liability *in solidum*." See too *Thompson v Harrison* (1787) 2 Bro CC 164, 29 ER 94; *Re EWA* [1901] 2 KB 642; and for consideration of the question whether the release of one of several defaulting trustees operates to release the others, see Mitchell, above n 41, 217, n 32.

In *Jyske Bank (Gibraltar) Ltd v Spjeldnaes* (Ch D 23 July 1997) Evans-Lombe J held that in principle affirmation of the primary wrongdoer's breach would not enable a dishonest assistant to escape from liability, but the judges of the Court of Appeal took a different line. They held that the impugned transactions in the case had been nullities that could not be affirmed, and that in any case it had not been established on the facts that the respondent company had attempted to affirm them with full knowledge of all the circumstances: reported sub nom *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 520–1 and 522 (Nourse LJ) and 533 (Colman J). However, none of the appellate judges held that a dishonest assistant cannot rely on affirmation of the primary breach in his defence, and it seems that Nourse LJ would have granted the appellant leave to amend his pleadings to rely on this argument but for the two matters already mentioned: *Heinl* (above) 522–3.

rights of action against the dishonest assistant, will be entitled to pursue the dishonest assistant afterwards.[364] It should also be borne in mind that[365]

> affirmation of a breach of trust or fiduciary duty is, like concurrence, release or acquiescence, an equitable defence . . . and [that those] who invoke [these defences] must show that the beneficiary or person to whom the duty is owed had a sufficient knowledge of the facts constituting the breach and its consequences to make it fair and equitable, in all the circumstances of the case, that he should be barred from obtaining the relief to which he would otherwise have been entitled.

If the claimant enters a settlement agreement in writing with the primary wrongdoer and afterwards sues a third party for dishonest assistance, there is no need to join the primary wrongdoer as a party to the action, to determine whether the agreement operates to release the dishonest assistant from liability as well, as this is a question of law that can be determined in the primary wrongdoer's absence.[366]

It seems arguable that an exemption clause in a trust document which releases the trustees from liability for breach of duty should have the effect of releasing their dishonest assistants as well.[367] However, the discretionary nature of the court's jurisdiction to excuse a trustee from liability under the Trustee Act 1925, section 61, is such that the courts should have no difficulty in excusing a trustee from liability under this section while simultaneously fixing a dishonest assistant with liability.[368]

## 2 Limitation

As has been discussed in part B above, dishonest assistants are often said to be personally liable "as constructive trustees," but in this context the phrase means that they are personally liable "as though they were express trustees which in fact they are not," and not that they are personally liable "because a constructive trust

[364] *Northland Bank v Willson* (1999) 249 AR 201, 212–3 (Wilkins J).

[365] *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 522 (Nourse LJ), citing *Re Pauling's ST* [1962] 1 WLR 86, 107 (Wilberforce J) (concurrence) and *Holder v Holder* [1968] Ch 353 (acquiescence). See too *Shenzen City Luohu District Industrial Development Co v Yao* (British Columbia Sup Ct 25 April 2000) para 205 (Williams CJSC): a share transfer agreement purporting to govern the relationship between a claimant and a primary wrongdoer was not binding on the claimant where it had not known of the primary breach at the time of entering the agreement. At para 219, Williams CJSC notes that "if the share transfer agreement in such circumstances were to bind an innocent person in the plaintiff's position, a person who has, unbeknownst to another, acted in breach of trust, would be permitted to enter into a subsequent agreement offering to pay even more money than what was owing (without any intention of honouring it) in order to defeat a claim for fraud or breach of trust. That cannot be the law."

[366] *Chan Kern Miang v Kea Resources Pte Ltd* [1999] 1 SLR 145.

[367] Cf discussion in part C, s (2)(a) above.

[368] Cf *Macdonald v Hauer* (1976) 72 DLR (3d) 110, where Bayda JA would have invoked an analogous statutory discretion to relieve two co-trustees from liability for a breach of trust while simultaneously fixing the third with liability.

has been imposed on property of which they are the legal owners." Hence, as Millett LJ reiterated in *Paragon Finance plc v D B Thakerar & Co*,[369] references in the Limitation Act 1980 to "trustees" do not apply to them, even though they do apply to constructive trustees proper.[370]

The question therefore arises, how the Limitation Act 1980, section 21, affects claims against dishonest assistants. The relevant sub-sections are:

(1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action:

(a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy . . .

(3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued.

So far as section 21(1) is concerned, it follows from what has been said above that in principle a dishonest assistant cannot himself be the "trustee" referred to in paragraph (a), and that the "trustee" referred to there can only be the primary wrongdoer. This suggests that in principle it cannot be right to say that "the accessory [probably] remains always unable to plead a defence of limitation, since his dishonesty will suffice to bring him within section 21(1)(a)."[371] The better view must rather be that if an action for dishonest assistance is relevantly an action "in respect of" a primary breach of trust—and it is submitted that it is[372]—then the action will be affected by section 21(1)(a) in the event that *the trustee* has acted fraudulently, but if he has not then it will not be affected. And in the latter case, section 21(3) would therefore seem to apply, again on the assumption that an action for dishonest assistance is an action "in respect of" the primary breach. The editors of *Lewin on Trusts* quite rightly dislike this conclusion.[373] It means that there are two different limitation rules

[369] [1999] 1 All ER 400, 408. Cf *Soar v Ashwell* [1893] 2 QB 390, 396 (Bowen LJ); *Taylor v Davies* [1920] AC 636; *Clarkson v Davies* [1923] AC 100; *Competitive Insurance Co Ltd v Davies Investments Ltd* [1975] 1 WLR 1240; *Tito v Waddell (No 2)* [1977] Ch 106, 249 (Megarry V-C).

[370] Cf Limitation Act 1980, s 38, which provides that "trust" and "trustee" should have the same meaning in the Act as in the Trustee Act 1925; the Trustee Act 1925, s 68(1)(17) extends the meaning of these terms to "implied and constructive trusts."

[371] J Mowbray et al (eds) *Lewin on Trusts* (17th edn Sweet & Maxwell London 2000) para 44–45. In their support, the editors cite a decision of the Manx High Court: *Barlow Clowes International Ltd v Eurotrust International Ltd* (1998/99) 2 OFLR 42, which they state was "not followed on another point" in the *Paragon Finance* case. However, it is submitted that the *Barlow Clowes* case is inconsistent with Millett LJ's decision on this point as well.

[372] Cf *Re Diplock* [1948] Ch 506, 512–3 (per curiam), construing the statutory precursor to the Limitation Act 1980, s 22; *G L Baker Ltd v Medway Building and Supplies Ltd* [1958] 1 WLR 1216, 1221–2 (Danckwerts J).

[373] *Lewin on Trusts* (n 371 above), para 44–45.

for dishonest assistance actions whose applicability turns on a question which the *Royal Brunei* case expressly held to be irrelevant to the dishonest assistant's liability, viz the question whether the primary wrongdoer was himself dishonest. However, it is submitted that the appropriate response to this anomaly is for Parliament to amend the wording of section 21 to reflect the change in the law wrought by the *Royal Brunei* case, and not for the courts to fudge the meaning of the term "constructive trustee" in order to fit dishonest assistants into section 21(1)(a) as "trustees" in their own right, as the editors of *Lewin* suggest.

### 3 Contributory Negligence

In *Equiticorp Industries Group Ltd (in stat man) v R (No 47)*,[374] Smellie J held that the shareholders of a company whose directors had committed a breach of fiduciary duty in which the defendant had assisted "should have taken care to ensure that they knew what [the directors] were up to." For this reason, he reduced the equitable compensation payable by the defendant to the company by 2.5 per cent. This part of Smellie J's decision is out of line with English law, under which it is no defence to a claim for dishonest assistance that the claimant could have discovered the primary breach of duty but negligently failed to do so.[375] In this respect, the English equitable rule mirrors the common law rule in relation to tort actions for deceit.[376] Even under English law, though, it should not be forgotten that a claimant who discovers a continuing primary breach of duty and takes no action to stop it may be debarred by his acquiescence from suing a dishonest assistant in respect of subsequent losses.

### 4 Section 61 of the Trustee Act 1925

The Trustee Act 1925, s 61, empowers the court to relieve "a trustee" from personal liability for breach of trust where he has acted honestly and reasonably and ought fairly to be excused. In a Canadian case, *Hub City Supplies v Total Drywall Ltd*,[377] Dillon J held that an equivalent Canadian statutory provision empowers the court to relieve "knowing assistants" from liability in appropriate circumstances, because they are liable "as constructive trustees" and so fall

[374] [1998] 2 NZLR 481, 659–660. Cf *Banque Nationale de Paris v Hew* [2001] 1 SLR 300, 338 (Lai Kew Chai J), describing the claimant as "the author of its own misfortune" through its failure to prevent its employee's rogue dealings on the foreign exchange markets.
[375] *Corporación Nacional del Cobre de Chile v Sogemin Metals Ltd* [1997] 1 WLR 1396.
[376] *Corporación Nacional del Cobre de Chile v Sogemin Metals Ltd* (n 375 above) 1402 (Carnwath J). For the position at common law, see most recently *Standard Chartered Bank v Pakistan National Shipping Corp (No 4)* [2001] QB 167.
[377] British Columbia Sup Ct 16 Sept 1996, paras 19–20.

within the scope of the section. However, for reasons which have already been discussed in part B above, and which were revisited in section 2 of this part, this analysis is predicated on a misunderstanding of the nature of accessory liability, and the better view is that the Trustee Act 1925, s 61, does not apply to dishonest assistants. Even if they fell within its scope as "constructive trustees", it would in any case be impossible far an English court to relieve a *dishonest* assistant from liability on the ground that he had acted honestly.

## E CONCLUSION

For reasons which may be obvious by now, the title "Conclusion" is not particularly apposite for this (very brief) final part. The rules on dishonest assistance are in a state of flux. The courts have applied and considered these rules in numerous cases over the past few years, and no doubt they will continue to do so. The boundaries of this type of equitable liability are expanding, as claimants seek to fix third parties with liability for participating in primary breaches of duty that are becoming increasingly remote from breaches of the core duties owed by an express trustee to his beneficiaries. The difficulties which have dogged the courts for many years in their efforts to define the mental element of liability have not gone away, but to some extent Lord Nicholls' dishonesty test has enabled the courts to suppress these difficulties, by authorising them to ditch the super-subtle distinctions of the *Baden, Delvaux* jurisprudence in favour of a more rough-and-ready approach. Many points of detail have been resolved, but some central questions remain to be answered. In particular, the relationship between dishonest assistance, knowing receipt, and inducement has not yet been worked out, and perhaps will not be worked out until the courts develop a consistent—and coherent—understanding of the relationship between the law of unjust enrichment, the law of property, and the law of wrongs.

# 7

# *Receipt*

PETER BIRKS

IF A PERSON has equitable but not legal title to money or other assets what claims does he have against a stranger into whose hands they fall? This question has been much debated, and in recent years the debate has been accelerated, not only by new cases, but, and indeed more so, by two articles of major importance, one by Lord Nicholls of Birkenhead[1] and the other by Professor Lionel Smith.[2] With one notable Australian exception,[3] the most recent contributions have tended towards excluding any strict liability claim whether in unjust enrichment, such as was favoured in Lord Nicholls' article, or in wrongs. Yet Lord Nicholls' position remains the only acceptable one, and the present purpose is simply to defend it.

This chapter considers three kinds of claim: (A) the direct assertion of proprietary entitlement to an asset (vindication); (B) the assertion of a personal claim arising from the wrong of misappropriation; and (C) the assertion of a personal claim arising from unjust enrichment. The paper argues, against Lionel Smith, that, having (A) and (B), equity must accept (C), on pain not only of creating indefensible asymmetries with the common law, but also of tolerating contradictory commitments internal to itself. An important theme in relation to (B) and (C) is that, rather than asserting that the traditional liability for "knowing receipt" is a liability in unjust enrichment or is a liability for a wrong, it is better to say simply that its case law has become confused precisely because it has tried to straddle both these two very different liabilities. The crucial point, as Lord Nicholls saw, is not to endow knowing receipt with a particular character but to ensure that the liability in unjust enrichment is not denied or ignored. We have to escape from the old name and from its singularity. One name suggests one kind of liability. In fact there are two.

*Re Montagu's Settlement Trusts*[4] provides a convenient platform for this discussion. It was decided by Megarry V-C 16 years ago, on 29 March 1985. If

[1] Lord Nicholls of Birkenhead "Knowing Receipt: The Need for a New Landmark" in WR Cornish et al (eds) *Restitution, Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Oxford 1998) 231.

[2] L D Smith "Unjust Enrichment, Property and the Structure of Trusts" (2000) 116 LQR 412.

[3] P Creighton and E Bant "Recipient Liability in Western Australia" (2000) 29 UWA L Rev 205.

[4] [1987] Ch 264.

we ask how it would now be decided, we will address all the essetial issues. It will be recalled that trustees, in breach of trust, had released some trust assets to the tenant for life, the tenth Duke of Manchester. The assets in question were valuable chattels, such as paintings and furniture. The breach was technical and procedural. The trustees had a power to release such assets but only after taking certain steps, which they had not taken. Nothing turns on the nature of the breach, except that it explains why it was possible for Megarry V-C to come to the conclusion that there had been no dishonesty on the part of either the trustees or the tenth Duke. The action was brought after the death of the tenth Duke by his successor, the eleventh Duke, who was a beneficiary under the trust. One objective was to compel the estate of the tenth Duke to replace in money the value of the assets which he ought not to have been given.

The action failed. Megarry V-C took the view that, since it had not been shown that the tenth Duke's estate still included any of the trust assets or their traceable proceeds, so that the only question was whether he had been under a personal obligation to repay the value he had received, the claimant would have had to establish that the old Duke had been at fault. He found that the old Duke had not been at fault at all. He certainly had not been dishonest. That is, he had not known that he was not entitled to the assets, he had not shut his eyes to the possibility that he was not entitled to them, and he had not recklessly failed to make the inquiries that an honest and reasonable person would have made. The old Duke had not even been careless. The trustees had thought that they were entitled to transfer the assets. It had been entirely reasonable for him to rely on them. Since the old Duke had not been guilty of any fault at all it was not necessary to decide what degree of fault would have made the Duke liable. However, Megarry V-C inclined to the view that the claimant would have had to prove dishonesty.

In revisiting this case, this paper adheres to the division which Megarry V-C himself emphasized, between property and obligations or, in other words, between proprietary claims and personal claims. The connection between "personal claims" and the law of obligations is not immediately lucid. Obligations correlate with rights *in personam* or, avoiding the Latin, with personal rights. Your obligation to pay me £1000 correlates with my right against you personally that you pay me £1000. A personal claim is the assertion of a right of that kind. Hence a personal claim is a claim made in the law of obligations or, in other words, a claim to enforce an obligation.

Apart from the structural commitment to the distinction between proprietary claims and personal claims, this paper also begins from another commitment of principle. The principle in question is that, except so far as differences are inescapably dictated by authority or demanded by reason, wealth should be protected to precisely the same extent whether it is held at law or in equity behind the curtain of a trust. It happens that there are these two modes in which wealth can be held. A painting may be a trust asset in which one or more persons have beneficial interests, or it may be owned or co-owned at law. Again,

and very importantly, the new market mechanisms which take advantage of computer technology mean that ever more investors in shares and other company securities acquire only equitable interests. The reason is that the legal title is likely to be consolidated in some bank acting as a custodian for many clients.[5] Since the choice of the mode of holding—directly or behind the curtain of a trust—will often be largely fortuitous, it seems right in principle that it should make as little as possible difference.

This commitment does not seek to deny that there are differences between law and equity which, whether or not they are desirable, have to be accepted. They could not be overcome other than by statute. So, for example, in equity one can bring a pure proprietary claim, while at law one cannot. Again, an equitable interest is always vulnerable to the purchase for value of the legal estate without notice, while at law there is no such general exemption from the axiom that nobody can confer any greater interest than he has (*nemo dat quod non habet*). These differences are much too deeply rooted to be eliminated, though even they can be, and have been, minimized. To exaggerate or exacerbate them would be grossly irresponsible.

## A THE VINDICATIO

In the assertion of proprietary rights there is an immediate and inescapable difference between law and equity. At law there is no claim in respect of errant chattels simply in the form "I say that that painting by Cézanne is mine!" Personal property is protected only indirectly, through the law of obligations. At common law, in other words, there is no *vindicatio*. If and when the Ashmolean Museum finds its stolen Cézanne, the language of its pleading will not amount to "That painting is mine!" but either "Because you have committed a wrong by misappropriating that painting, you have come under an obligation to me" or, perhaps, "Because you have been unjustly enriched at my expense by the receipt of that painting, you have come under an obligation to me."

The word "vindication" is sometimes used very loosely of any claim which protects wealth or redresses interference with wealth.[6] That flies in the face of two millennia of consistent usage in the western legal tradition according to which a *vindicatio rei* is a direct assertion of a right in a thing. A claim which asserts "I say that you have come under an obligation to pay me damages for misappropriating my Cézanne!" does, in the loosest lay sense, vindicate my property right, but it is not properly speaking a *vindicatio* and it should never be referred to as such. It asserts the proprietary right obliquely or

[5] J Benjamin *Interests in Securities* (OUP Oxford 2000) 17–30; A O Austen-Peters *Custody of Investments* (OUP Oxford 2000) 2–10.

[6] Graham Virgo expressly adopts this wide sense: G Virgo *The Principles of the Law of Restitution* (OUP Oxford 1999) 11–16, 656, 664–668.

indirectly.[7] There is no vindication of chattels at common law. However, in equity there is. A claimant can ask a court to declare that the defendant holds the Cézanne on trust for him. In effect he is then directly asserting that the painting is his in equity. He is asking the court to uphold that proposition and to declare it to be true.

There was no attempt in *Re Montagu* to show that any of the misdirected chattels or their traceable proceeds survived in the estate of the old Duke. However, Megarry V-C did not entirely ignore that kind of claim. Nor can we ignore it, for the *vindicatio* is part of a package, the other parts of which are, as at law, claims which protect wealth through the law of obligations. Even though we are primarily interested in those obligations, we shall not be able to assess their nature and scope other than as parts of the whole package of instruments which equity uses to protect wealth.

There are only two points which need to be made at this stage. The first was made by Megarry V-C himself. Had the claimant been able to show that the old Duke's estate still included any of the chattels which had been wrongfully released to him, or their traceable substitutes, the declaration that those assets belonged to the trust and the consequent order for their delivery up would have been entirely independent of fault.[8] So long as the Duke was in possession of those assets his innocence could never have been an answer to the *vindicatio*.

The second point is much more complex and will require a little space. It is that the claim in respect of the asset received is importantly different from the claim to its traceable substitute. The contrary has recently been assumed by the House of Lords and, for that reason, it needs all the more emphasis. If the claimant's right in the substitute were the same right as the right in the original there would be no room for it to have its own causative event, and the House of Lords expressly says that it does not. But this too is certainly wrong. The right in the substitute is not the same right, and it does have its own causative event. This has to be fully explained. As will be seen below, it is an essential part of the argument that the exclusion of the personal claim in unjust enrichment is rationally indefensible.

The contrary position, that the right in the substitute is the same as the right in the original and has the same causative event, is prominent in *Foskett v McKeown*.[9] In that case a trustee had stolen trust money to pay the premiums of a life insurance policy. Some while later he killed himself. The House of Lords held that the beneficiaries under the trust were entitled to a beneficial interest in the one million pound death benefit in the same proportion as trust money had been used to pay the premiums.[10] The equitable interest which arose under the express trust which was later plundered simply persisted in the trace-

[7] The *Shorter OED* (OUP Oxford 1993) gives as the fifth meaning of the verb "vindicate" "Assert or maintain by means of an action, esp. in one's own interest; defend against encroachment or interference." The true *vindicatio* asserts the proprietary right directly: "That thing is mine!"

[8] [1987] Ch 264, 271.

[9] [2000] 2 WLR 1299 (HL).

[10] It has been acutely observed that even this result violates the principle that a trustee must take no profit from his trust: A Berg "Permitting a Trustee to Retain a Profit" (2000) 117 LQR 366, esp 370–371.

able substitute for the plundered money. Thus Lord Browne-Wilkinson takes the view there is no new causative event at all:[11]

> The only trusts at issue are the express trusts of the purchasers' trust deed. Under those express trusts the purchasers were entitled to equitable proprietary interests in the original moneys paid to Mr Deasy by the purchasers. Like any other equitable proprietary interest, those equitable proprietary interests under the purchasers' trust deed which originally existed in the moneys paid to Mr Deasy now exist in any other property which, in law, now represents the original trust assets.[12]

The same thought runs through the leading speech of Lord Millett. He speaks of "the transmission of a claimant's property rights from one asset to its traceable proceeds"[13] without sensing any need to explain how such transmission might be possible.[14]

This will not bear closer analysis. The plundered beneficiaries ended up with a right in something which they never owned before and a right of a kind which they never had before—a co-ownership with outsiders. This can be made more graphic. Suppose the trustee took trust money and, adding some of his own, bought a car. At the conclusion of the story the plundered beneficiaries have a share in a car. The object of the right is now different. At the beginning of the story there was no car in sight. And the nature of the right is not the same. It cannot rationally be asserted that the co-ownership of the car arose from the transfer and declaration which created the plundered trust. Clearly it has arisen by operation of law. And the law operates upon events. The co-ownership of the car has been triggered by a causative event, and that causative event must be described and named. The same is true of the death benefit in *Foskett v McKeown*. Any other conclusion must be a fiction.[15]

The law improves its rationality by seeing through fictions. If a right arises by operation of law its causative event can always be named. We often do it without

[11] Mr Virgo shares this approach, for his treatment of proprietary interests appears to assume their persistence in their substitutes, and no discussion is devoted to any distinct causative event: Virgo (n 6 above) 642–645.

[12] [2000] 2 WLR 1299 (HL) 1304 EF; cf 1223 AB (Lord Millett).

[13] [2000] 2 WLR 1299, 1322H–1323A; cf 1327 C–D.

[14] Rather differently, Lord Hoffmann indicates that there was a new event but that it was what the Romans would have called a *confusio* [2000] 2 WLR 1299 (HL) 1311; cf Justinian, *Institutes* 2.1.27–28. A *confusio* was a physical mixture of two fluid substances in one vessel. Its effect was to turn the contributors into co-owners of the resultant mass. However, on the facts there never was any *confusio*, only a substitution. If I steal money and pay it into my bank account, there is no mixture of money, not even if the account is in credit. There is a substition, money for enhanced claim against the bank. If the money is "taken out of the account" there is another substitution. And if the money thus obtained is used to buy another asset, there is yet another substitution. Furthermore, had there been a mixture, the rules of *confusio* have nothing whatever to say about substitutes for the original mixture. If you mixed my wine and your wine together and sold it or exchanged it, I obtained no property rights in the money or the other exchange product.

[15] Professor Burrows recently sought to expose this fiction in AS Burrows "Proprietary Restitution: Unmasking Unjust Enrichment" (2001) 117 LQR 412. However, although his views are very close to those expressed here, he speaks throughout his article of the property fiction. But the proprietary right is real enough; the fiction is that the right in the substitute can be explained by the event which accounts for the right in the original asset.

thinking. The property in a tree which grows or a building which is constructed on a neighbour's land passes to the neighbour. The event is, generically, *accessio*, the accession of minor to major. As with its cousin *specificatio,* the Roman term has been made familiar by long use,[16] though "annexation" is often preferred.[17] In our present context, the event is non-consensual substitution. In our law if D has possession of C's asset and, without C's consent, exchanges it for another asset, by operation of law C acquires rights in the substitute which as closely as possible reflect the rights which he had in the original. There is no hallowed Roman term, for the simple reason that not every system recognises that substitution generates rights in the substituted asset, and Roman law did not.

It is not sufficient to name the event. It must also be placed in its correct family. All rights which arise by operation of law arise from a wrong, from an unjust enrichment, or from some other causative event. We know that non-consensual substitution works independently of wrongdoing. In *Trustee of FC Jones & Sons v Jones*[18] the Court of Appeal gave full effect to a chain of substitutions but without one word said of any wrong. The effect attaches to non-consensual substitution, even in the absence of any wrong. Hence substitution must be either an unjust enrichment or a miscellaneous other event.

Mr Swadling thinks that substitution must be placed in the miscellaneous category[19] alongside accession and specification. They too work by operation of law and without wrongdoing. There is no doubt that both of those events must be placed in the miscellaneous category. It is impossible to say that either is contemplated as responding to an otherwise unjust enrichment. Accession and specification enrich the person who becomes owner of the whole, without the least regard to an inquiry into the desirability of stripping the other. Hence Swadling is indisputably correct in treating both of them as neither "wrongs" nor "unjust enrichments" but rather as "miscellaneous other causative events." Substitution is a much more difficult case.

In my view non-consensual substitution is a species of unjust enrichment. Professor Lionel Smith shares the same position.[20] Professor Burrows has recently made a strong argument to the same effect.[21] If D uses money from a trust fund and buys himself a Jaguar car, he can be said to have enriched himself at the expense of the beneficiaries.[22] He has enriched himself by acquiring

[16] W Swadling in P Birks ed *English Private Law* (OUP Oxford 2000) 4.476, 4.563; S Gleeson *Personal Property Law* (FT Law and Tax London 1997) 55.

[17] *Holland v Hodgson* (1872) LR 7 CP 328, 334 (Blackburn J); *Berkley v Poulet* (1977)241 EG 911 (CA) 913 (Scarman LJ).

[18] [1997] Ch 159 (CA).

[19] WJ Swadling (n 16 above) 4.477–483.

[20] LD Smith *The Law of Tracing* (OUP Oxford 1997) 300.

[21] AS Burrows (n 15 above) esp 418–419, 422–423.

[22] So also L D Smith (n 2 above) 423–425. This important article is considered in section C below. He would now place such cases in a special category of unjust enrichment which he calls "title-based claims." Such claims in his view are not dependent on any notion of subtraction from the claimant, which is applicable only to "defective transfer" claims.

a valuable chattel, which he himself chose to obtain. That enrichment can be said to have been obtained at the beneficiaries' expense, because, although the Jaguar was never theirs, nevertheless it was obtained by using their money, and there is an unjust factor in the absence of their consent.[23] Absence of consent is a fortiori from mistake. One who transfers money by mistake gets it back because his consent to the transfer was impaired. One from whom wealth moves absolutely without consent must have at least an equal case for getting it back. And here the law does give it back. It does so by raising a new proprietary right in the substitute.

If we were to follow Swadling in taking it out of unjust enrichment, we would come up against a serious difficulty. The miscellaneous category is indeed miscellaneous, but one by one each event within it has some reason behind it. What reason can be given why the law should give substitution proprietary effect or indeed any effect at all? In this respect substitution is quite different from accession and specification. They pose practical problems which just have to be solved. What happens to the ownership of the wool which darns the sock? And who owns an entirely new thing made with materials belonging to another, the wine made from another's grapes?

There is no such problem in relation to substitutions. Unless to reverse unjust enrichment, there is no reason for the law to meddle with the substitute at all. And, as we have noticed, some systems do not, though none ignore accession and specification. Therefore, if you accept that every causative event must have a rationale, you are driven to the conclusion that the common law raises rights in substitutes because it takes the view that a substitute obtained in exchange for someone else's thing, as where a Jaguar is obtained with money or shares belonging to another, is an example of an unjust enrichment at the expense of that other.

However, Mr Swadling appears to have on his side the support of the House of Lords. The House, following the line taken by Mr Virgo,[24] says that the claim of the plundered beneficiaries has nothing whatever to do with unjust enrichment.[25] However, that is not said quite in the manner in which Mr Swadling says it. The House of Lords excludes substitution from unjust enrichment partly through failing to identify it as the relevant causative event and partly by

[23] The premise of this proposition is that the opportunities inherent in any item of property belong to its owner, so that to enrich oneself by usurping those opportunities is to intercept that which the law already attributes to the owner. On this basis even the claim which was made in the famous Kentucky Cave case, *Edwards v Lee's Administrators* 96 SW 2d 1028 (1936), can be understood as based on an interceptively subtractive enrichment: see E Weinrib, "Restitutionary Damages as Corrective Justice" (2000) 1 Theoretical Inquiries into Law 1, cf E Weinrib "The Juridical Classification of Obligations" in P Birks ed *The Classification of Obligations* (OUP Oxford 1997) 37, 47; see also P Birks in P Birks ed *English Private Law* (OUP Oxford 2000) 15.06–15.08. This is not to say that the Kentucky case cannot be explained as restitution for the wrong as such, only that it can by alternative analysis be explained as an interceptive unjust enrichment.

[24] Though the words resemble his very closely, his work is not acknowledged in the judgments, perhaps because it was not acknowledged by counsel.

[25] [2000] 2 WLR1299 (HL) 1304 CD,1306 D, 1311 C–D, 1322H–1323A; cf 1327 C–D.

embracing an indefensible logical opposition between property and unjust enrichment. That contrast cannot be made, no more than one could say that a claim arose in obligations and not in unjust enrichment. Such propositions violate the principles of logic. Property and obligations are co-ordinate categories of response to events, while unjust enrichment is an event. Property rights (rights *in rem*), no less than obligation rights (rights *in personam*), arise from events, and unjust enrichment is a generic description of one family of such events.

Logically one cannot create an exclusive opposition between causative events and responses any more than between mammals and carnivores. Empirically it might have happened that no meat-eating mammals evolved. Empirically it might be that unjust enrichment triggered only rights *in personam*. We have just seen that the crucial question is whether non-consensual substitution, which does engender proprietary rights, is a species of unjust enrichment or one of the miscellaneous other events. The false logical opposition between event and response makes it impossible to ask that question. We have to conclude, from the fallacy on which it is based, that the House of Lords' apparent support for Mr Swadling's position cannot bear any weight.

If Mr Swadling is right, it belongs in the latter category, "miscellaneous other events." Non-consensual substitution is not then an instance of unjust enrichment but one of an unruly miscellany each with its own rationale. And if that is so the House of Lords was empirically, and fortuitously, right to say that the claim had nothing to do with unjust enrichment. The claimants were asserting a proprietary right, and that proprietary right did not arise from unjust enrichment. But if the contrary view is right the claimants have to be seen as asserting a proprietary right which did arise from unjust enrichment. On the one view the claimants were located at one and the same time in the law of property and the law of miscellaneous other events. On the other view, they were located at one and the same time in the law of property and the law of unjust enrichment.

A parallel example is to be found in *Attorney-General for Hong Kong v Reid*.[26] Reid, a very senior prosecutor had received huge bribes to protect certain criminals. The Privy Council held that by operation of law Reid became a trustee of every bribe received; or, in other words, in equity every bribe received by Reid immediately vested in his employer, the government of Hong Kong. If we stop the story at that point, the entitlement of the government of Hong Kong must be said to arise in the law of property and, simultaneously, in the law of wrongs. The causative event in question was the wrong of breach of fiduciary duty, and the right triggered by that event was a proprietary right.

However, there is then a complication. The claim was not made in respect of the money received but in respect of its traceable substitute. Reid had invested the bribes in farms in New Zealand. The government of Hong Kong was able to assert a beneficial interest in those farms. According to what has been said

[26] [1994] 1 AC 324 (PC).

above, the right in the farms cannot be explained as the same right persisting in a new thing. It is a new right attributable to a new event. And that event is non-consensual substitution. The same argument then leaves the Swadlingites saying the right in the farms arose in the category of miscellaneous other events and their opponents saying it arose in unjust enrichment. The Hong Kong government's proprietary right in the money received arose from the wrong, while, on one view, the right in the substitute arose from unjust enrichment.

The lesson is that one cannot create a clean logical opposition between causes and responses, hence not between the law of wrongs and the law of property, nor between the law of unjust enrichment and the law of property, nor between the law of miscellaneous other events and the law of property. Put another way, the *vindicatio* requires the claimant to substantiate its abstract proposition—"I say that painting by Cézanne is mine!"—by reference to events which in law have that consequence. The consequence is a property consequence. Property being a category of response, it is that consequence which places the claim unequivocally in the law of property. The relevant causative events may be of any kind. They may be manifestations of consent, or wrongs, or unjust enrichments, or miscellaneous others. Every property claim belongs in one of those columns.

The most obvious reason why this debate has to be drawn out into the open is that, if on reflection it turns out to be correct to say that non-consensual substitution is a particular instance of unjust enrichment, the rights so generated will be vulnerable to the defence of change of position. Otherwise not. Vulnerability to change of position is the special weakness of all rights generated by unjust enrichment, whether personal or proprietary. Within the law of property, that vulnerability is the distinctive feature of property rights generated by unjust enrichment. It is unsafe and misleading to characterize property rights arising from other events as "pure property rights" and then to distinguish, presumably as "impure," those property rights which are born of unjust enrichment.[27] Property rights born of unjust enrichment are as "pure" as any others, but they are more fragile in this one respect.[28]

What we have said so far is that in *Re Montagu*, had it been shown that the estate contained traceable substitutes for the assets received by the old Duke, they could have been vindicated. The action for a declaration that assets are held on trust is a direct assertion of an equitable property right and is properly

[27] Nor should the line be drawn between "restitutionary" property rights and all others, for this one fragility is a feature only of those restitutionary property rights which arise from "unjust enrichment." This implies small but significant disagreements with A Burrows (n 15 above) 417–418.

[28] Goff and Jones would seem to think it desirable that property rights arising from unjust enrichment should also be discretionary "to take into account facts such as the defendant's honesty or insolvency": G Jones (ed) Lord Goff of Chieveley and G Jones *The Law of Restitution* (5th edn Sweet and Maxwell London 1998) 81. However, they notice that the courts have been hostile to this notion. Cf G Jones *Hochleaga Lectures: Unresolved Problems in the Law of Restitution* (Sweet and Maxwell Asia 2001) 13. In my own view this hostility should be maintained: P Birks "The end of the remedial constructive trust?" (1998) 12 Trust L Intl 201–215.

called a *vindicatio*. It would not have been necessary to prove any kind of fault on the part of the old Duke. In respect of traceable proceeds of the original assets, the assertion of the equitable property right would have been substantiated by proof of substitution. Substitution is, though not all agree, a species of unjust enrichment. Hence the *vindicatio* would have been based on unjust enrichment—a proprietary claim in unjust enrichment. We will come back to this below. The existence of this *vindicatio* in respect of traceable substitutes and the rationale behind it form a crucial part of the case for admitting the as yet unrecognized personal claim in unjust enrichment. The argument will be that it is impossible to admit the proprietary claim arising from unjust enrichment without also allowing the beneficiaries the personal claim arising from the same event. It amounts to an inexplicable inconsistency.

### B THE WRONG OF MISAPPROPRIATION

The word "misappropriation" is chosen as a means of getting above the current language of law and equity. Since Roman law knew a civil wrong of *furtum* it is tempting to say simply "theft" or, to escape the criminal overtones, "civil theft." However, let it be "misappropriation." One way of protecting wealth in private law is to impose an obligation on those who wrongfully misappropriate it. A personal claim based on the wrong has in one important respect a longer reach than the *vindicatio*. It does not depend in any way on the defendant's still having in his hands the thing or its traceable proceeds. The obligation to pay arises simply from the commission of the wrong.

The common law divides the wrong of misappropriation between trespass to goods and conversion. But nowadays conversion is so dominant that we can, for present purposes, confine our attention to it. Conversion came into the law equipped with a requirement of dishonesty. That is, the old action on the case always rehearsed that the conversion had been dishonest.[29] The requirement of dishonesty was stripped out. It became fictional. So long as the forms of action persisted, the words remained, but they could not be traversed. Conversion thus became what it is now, a tort of strict liability.[30] The reason is obvious. The

[29] "[the defendant] . . . knowing the goods and chattels aforesaid to be [the claimant's] . . . and contriving fraudulently . . . to deceive and defraud . . . converted" *Wickham v Sperring* in J Lilly *A Collection of Modern Entries* (5th edn A Strahan and W Woodfall London 1791).

[30] It is not easy to pin down the moment at which the strict nature of liability for conversion became established. It is certainly the law from the mid–18th century: *Hartop v Hoare* (1743) 2 Str 1187; *Cooper v Chitty* (1756) 1 Burr 20. Blackstone 3 *Commentaries* 153, though brief, is to the same effect. But Buller, for all the surprising length of his treatment, appears to go no further than to deny the availability of any special plea, adding nothing as to the irrelevance of evidence of innocence under the general issue: F Buller, *An Introduction to the Law relative to Trials at Nisi Prius* (3rd edn Strahan and Woodfall London 1781) 48–49. So far as anything can be made of it, the much earlier *Vandrink v Archer* (1590) 1 Leon 221 goes no further than to disallow the special plea. Cf *Gallyard v Archer* (1789) in JH Baker and SFC Milsom *Sources of English Legal History* (Butterworths London 1986) 535.

wrong had to cover the ground that would have been covered by the missing *vindicatio*.

One other point can usefully be taken at once. Ever since the House of Lords explained the old language of "waiver of tort" in *United Australia Ltd v Barclays Bank Ltd*[31] it has been clear that the victim of the wrong of conversion may elect between a claim measured by his loss (compensation) or by the defendant's gain (restitution). The one cause of action, the tort of conversion, generates these alternative rights. A sterile debate now persists as to whether both can be called "damages." It is safe to say "awards" or "money awards," but some people insist that a gain-based award cannot be "damages." This has to be borne in mind in deciding on the nature of the equitable liability for "knowing receipt." The *United Australia* case, though it deals only with the tort of conversion, drives home the lesson that, even supposing that it was pellucidly clear that the measure of recovery was gain-based, it could not be inferred from that restitutionary measure of recovery that knowing receipt was an instance of unjust enrichment rather than an example of a wrong. Restitution for wrongs stands outside the law of unjust enrichment. Restitution is multi-causal.[32] That being the case, it cannot follow that gain-based recovery must indicate a cause of action in unjust enrichment.[33]

## 1 A Shift of Strategy: Two Faces of Recipient Liability

Although I have myself strenuously argued that "knowing receipt" should be regarded as a claim in unjust enrichment, and should therefore discard the incongruous requirement of fault implicit in the word "knowing,"[34] the courts appear to have set their face against that view. It now seems right to abandon that analysis once and for all.[35] It was a mistake to insist that "knowing receipt" was simply a species of unjust enrichment which had been slow to understand itself and, in particular, slow to understand that liability in unjust enrichment is strict though subject to defences.

31 [1941] AC 1 (HL).

32 P Birks "Misnomer" in WR Cornish et al (eds) *Restitution, Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Oxford 1998) 1. Also multi-causalist, though using different series of causes, are: G Virgo *The Principles of the Law of Restitution* (OUP Oxford 1999); I D Jackman *The Varieties of Restitution* (Federation Press Annandale NSW 1998). Multi-causalism is not uncontested: AS Burrows "Quadrating Restitution and Unjust Enrichment: A Matter of Principle" [2000] Restitution LR 257, 269: "For the moment, I will continue to sing to the old hymn-sheet which quadrates the principle against unjust enrichment and restitution." Cf A Tettenborn "Misnomer—a Response to Professor Birks" in *Restitution, Past, Present and Future* 31.

33 P Birks "Unjust Enrichment and Wrongful Enrichment" (2001) 79 Texas L Rev 1767; J Edelman "Unjust Enrichment, Restitution and Wrongs" (2001) 79 Texas L Rev 1869; cf also A Kull "Disgorgement for Breach, the 'Restitution Interest', and the Restatement of Contract" (2001) 79 Texas L Rev 2022.

34 P Birks "Misdirected Funds: Restitution from the Recipient" [1989] LMCLQ 296.

35 First steps towards renunciation: P Birks "Property and Unjust Enrichment: Categorical Truths" [1997] NZL Rev 623, 651.

The better way of proceeding is to accept that the ambiguities and uncertainties in the case law of knowing receipt arise from its having failed to distinguish between two very different kinds of liability, one wrong-based and the other based on unjust enrichment. The task is then, not to force "knowing receipt" into one or other category, but to demonstrate that both kinds of liability are necessary and that neither renders the other redundant. Within the law of obligations the recipient of trust property can, on appropriate facts, be made liable for the wrong of misappropriation or he can be compelled to make restitution of his unjust enrichment. On its face the phrase "knowing receipt" is tendentious: it leans towards the wrong-based liability. In an excellent recent article Peter Creighton and Elise Bant preferred to put it on one side and to refer instead to "recipient liability."[36] That is most helpful. Recipient liability can be based on the wrong of misappropriation or on unjust enrichment.

It might be objected that this switch of strategy is premature. Signs of judicial sympathy for reformulating knowing receipt as a claim in unjust enrichment are not entirely lacking.[37] Creighton and Bant themselves make a strong case for converting the traditional liability to a strict liability in unjust enrichment and they show that there is already in place in Western Australia a statutory liability which, within its own sphere, does just that.[38] However, it would probably be as bad to suppress the wrong-based liability as it has been to refuse to allow the unjust enrichment liability to reach the surface. Besides, the Court of Appeal's recent decision to insist on a requirement of fault in knowing receipt comes as a heavy blow to any attempt to move the traditional liability lock, stock and barrel into the law of unjust enrichment.

We will have to come back to this below. In *Bank of Credit and Commerce International (Overseas) Ltd v Akindele*,[39] which will be further discussed below, Nourse LJ, with whom Ward and Sedley LJJ agreed, indicated that in his view a strict liability regime would be "commercially unworkable." He appeared to prefer that this particular example of restitution be not conceived as triggered by unjust enrichment but, so we must therefore understand, by a wrong:

> While in general it may be possible to subsume a further part of our law of restitution under the principles of unjust enrichment, I beg leave to doubt whether strict liability coupled with a change of position defence would be preferable to fault-based liability in many commercial transactions, for example where, as here, the receipt is of a company's funds which have been misapplied by its directors.[40]

[36] Creighton and Bant (n 3 above).
[37] Notably *Kooroortang Nominees Pty Ltd v ANZ* [1998] 3 VR 16 (Hansen J). Hansen J is the only judge, other than Lord Nicholls writing extra-judicially (n 1 above), to have accepted the logic of the case for a strict liability unjust enrichment claim.
[38] Creighton and Bant (n 3 above) 221–231.
[39] [2000] 4 All ER 221 (CA).
[40] [2000] 4 All ER 221 (CA) 236.

Nourse LJ admitted that the matter might be open for argument at a higher level, but it is clear that he thought that fault-based liability should prevail.

There should be no doubt that the rejection of strict liability is a rejection of the unjust enrichment analysis of knowing receipt. Strict liability is the essence of the law of unjust enrichment. If there were a general requirement of fault, the entire law of unjust enrichment could probably be swept into the law of civil wrongs. But that will not happen. So long as his assets, taken as a whole, remain swollen, the totally innocent recipient of, say, a mistaken payment has no effective answer to the demand for restitution. Neither carelessness on the part of the payer nor innocence on the part of the recipient are relevant.[41] The reason is that, to the extent that the assets remain swollen, the recipient is only being asked to give up value which he ought never to have had.

Nourse LJ expressed his preference for fault-based liability in the course of noticing, but leaving to higher authority, a very important article by Lord Nicholls.[42] In fact it appears not to have been noticed that Lord Nicholls himself, while in favour of recognizing a liability in unjust enrichment in these situations in which the claimant is entitled only in equity, was not arguing for a subsumption of knowing receipt under unjust enrichment. His strategy is precisely the one now argued for in this chapter. In short he seeks to show that it is necessary to recognize the liability in unjust enrichment alongside the liability for knowing receipt in its quality as a wrong. His point all along is that there have to be both liabilities. Lord Nicholls' recourse to this strategy is itself a reason for pursuing it and abandoning the attempt simply to pour knowing receipt into an unjust enrichment bottle. Rather than treat knowing receipt as a wrong, or as an unjust enrichment, it is much better to regard its case law as having failed to distinguish between these two figures.

## 2 Recipient Liability: The Wrong

So far as knowing receipt is treated as a wrong and, in particular, as the equitable version of the wrong of misappropriation, there remains a question which ought to be a good deal easier to answer in the absence of any distracting flirtation with unjust enrichment and the consequent gravitational pull of strict liability. What degree of fault is required on the part of the recipient? In *Re Montagu* Megarry V-C thought that it was a wrong which required dishonesty. At first instance in *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* Carnwath J agreed. This was, however, to overlook even Court of Appeal authority to the contrary, requiring no more than non-intentional fault

[41] Both these points were already clear in 1841: *Kelly v Solari* (1841) 9 M & W 54. That leading case does not, however, limit the proposition to the situation in which assets remain swollen. It knew nothing of the defence of change of position.

[42] Lord Nicholls of Birkenhead (n 1 above).

in the form of failure to discover what a reasonable person would have discovered. The Court of Appeal had said more than once that it was only necessary to establish that the recipient ought to have known of the trust provenance of the money.[43] In the *Akindele* case the Court of Appeal again applied this lower level of fault but, just when seeming to clear the waters, managed then to cloud them.

The facts were that BCCI's officers, behind its back, dishonestly assembled the bank's funds in order to honour the terms of an investment with the bank which, with a fraudulent purpose, they had earlier taken from Chief Akindele. The Chief had invested $10 million in 1985 on terms which entitled him to demand $16.679 million three years later. The BCCI liquidator wanted this sum back, ultimately confining his claim to the yield, namely $6.679 million. His claim failed.

This claim provided an ideal opportunity to reconsider the nature of the liability of one who receives another's equitable property without his knowledge. It is clear enough that the Court means to reject the requirement of dishonesty at one end of the spectrum and, as we have seen, the notion of strict liability at the other.[44] But in its final formulation the Court falls back into obfuscatory language. It says that we have to ask whether it would be unconscionable in the defendant not to repay. "Unconscionable" gives no guidance. At one extreme it is unconscionable not to repay what you were not intended to receive.[45] At the other extreme, it is unconscionable to be dishonest. "Unconscionable," indicating unanalysed disapprobation, thus embraces every position in the controversy. If we look at what the court did, rather than at the word in which it summed up the test which it intended to apply, we can see that Chief Akindele held on to his money as a result of a factual inquiry resembling an inquiry into constructive notice: he neither knew nor ought to have known of the improprieties going on inside BCCI.[46] In this inquiry "unconscionable" seems no more than a fifth wheel on the coach.

This point is made in a recent article by Susan Thomas.[47] She sets out to stabilize the uncertainties inherent in "unconscionable" by looking for the person who might at lowest cost prevent the loss. This is now a routine technique used by those who favour the normative application of economic analysis. Going down this line, it makes no sense at all to retain the word "unconscionable"

[43] *Belmont Finance Corp v Williams Furniture Ltd (No 2)* [1980] 1 All ER 393 (CA) 403–405; cf *Houghton v Fayers* [2000] 1 BCLC 511 (CA) 516.
[44] [2000] 4 All ER 221 (CA) 231–2, 236–7.
[45] This is explicitly discussed in *Kelly v Solari* (1841) 9 M&W 54, 152 ER 24 especially in the judgment of Rolfe B: "With respect to the argument, that money cannot be recovered back except where it is unconscientious to retain it, it seems to me, that wherever it is paid under a mistake of fact, and the party would not have paid it if the fact had been known to him, it cannot be otherwise than unconscientious to retain it."
[46] [2000] 4 All ER 221 (CA) 237–238.
[47] SB Thomas "Goodbye Knowing Receipt. Hello Unconscientious Receipt" (2001) 21 OJLS 239, 252–3.

since the inquiry into the costs of prevention is hardly capable of being related to ideas of good and bad conscience. Nevertheless her discussion points in the same direction in which the Court by its actual decision appears to have intended to take the law. That is to say, the unconscionable person as identified by her economic criteria turns out to be the person who could, in the circumstances, have reasonably been expected to discover the trust or fiduciary provenance of the assets received. This is the standard which in the past has been needlessly encoded in the language of constructive notice.

Despite the undesirability of the recourse to "unconscionable," it can thus be deduced in one way or another that the *Akindele* case constitutes a commitment to the view that the equitable version of the wrong of misappropriation requires fault less than dishonesty. What it requires is unreasonableness and, in particular, unreasonable failure to appreciate the trust provenance of the assets in question. A question must, however, be raised as to whether that position would or should hold if the liability in unjust enrichment, which is about to be discussed, were securely accepted. The defence of change of position, which is available against the strict liability in unjust enrichment, extends only to those who change their position in good faith. It has not yet been decided whether the disqualification from the defence is confined to those who have actual knowledge of their non-entitlement.[48] If, as seems likely, it is so confined, there would be an appearance of asymmetry and possibly even anomaly in having liability for the wrong of knowing receipt based on mere carelessness. For the wrong of knowing receipt would in effect cancel out the operation of the defence. This happens elsewhere on the boundary between unjust enrichment and tort and is not inexplicable, but it is not desirable. Once the unjust enrichment liability is in place, it may therefore seem best to recur to Megarry V-C's preferred position in *Re Montagu* and insist on a requirement of dishonesty, as in knowing assistance.[49]

Strict liability is not tied unequivocally to unjust enrichment. Mr Swadling would be willing to see the equitable recipient's liability as a proprietary wrong of strict liability closely analogous to conversion.[50] However, conversion is only a tort of strict liability because there is no common law *vindicatio*. On the equitable side there is not the same pressure. Moreover, if the strict but fragile liability in unjust enrichment is put in place alongside the equitable *vindicatio* a wrong of strict liability would make it unnecessarily difficult to explain the relationship between the different liabilities.

If, as seems probable, there will continue to be an equitable wrong of misappropriation its final shape will depend on what ultimately happens on the unjust enrichment front. If the unjust enrichment liability is recognized, the

[48] Further discussion, text to n 57 below.
[49] That dishonesty is required in the latter has been clear since the great judgment of Lord Nicholls in *Royal Brunei Airlines v Tan* [1995] 2 AC 378 (PC). Cf Ch 6 (Mitchell).
[50] WJ Swadling "Some Lessons from the Law of Torts" in P Birks (ed) *Frontiers of Liability* vol 1 (OUP Oxford 1994) 41, discussed as a possibility but without enthusiasm by Creighton and Bant (n 3 above) 220–221.

most probable future of the wrong will take it back to *Re Montagu*. It will be a wrong requiring dishonesty.

## C UNJUST ENRICHMENT

It is important to begin by noticing that, even at the level of the Court of Appeal, the *Akindele* case has not killed off strict liability in equity for unjust enrichment. First, the court did not draw a clear distinction between liability for a wrong and liability for unjust enrichment, with the consequence that it in effect considered knowing receipt only in its character as an equitable wrong.

Next, full consideration of the cause of action in unjust enrichment would not have produced a different result. Akindele himself would not have incurred that liability because on the facts as found he would have had the defence of bona fide purchase. Approaching the matter on the assumption that knowing receipt was to be treated as a fault-based wrong, the Court of Appeal had no need to consider the defence of bona fide purchase. Chief Akindele had given value to the fiduciaries from whom he received the money in question. That is, he had received only the contractual return on his investment. Since, on the Court's view, he could not be liable at all because BCCI could not show that he had failed to make reasonable inquiries, the discussion could not reach the defence. When the recipient is to be made liable for a fault-based wrong, even a donee cannot be liable unless and until the requisite degree of fault is established.[51]

Finally, the fears of commercial uncertainty, real as they may be in relation to a wrong-based liability, must be regarded as illusory in relation to unjust enrichment where the apparently awesome prospect of strict liability is in fact limited by vigorous defences. The strict liability encountered in relation to unjust enrichment is fragile. There would be no law of unjust enrichment at all, even at common law, if the fears of commercial uncertainty were real. All that can be said therefore is that the *Akindele* case has ruled out the kind of strict liability for a proprietary wrong which is contemplated by Mr Swadling.[52] It has said nothing whatever about the liability in unjust enrichment.

### 1 The Necessity of Strict Liability in Unjust Enrichment

The discussion cannot proceed without a simple demonstration of the appropriateness, indeed the necessity, of this fragile strict liability. The argument has nothing to do with equity and common law. It is pitched above both. Strict

[51] On this approach the curious discussion of bona fide purchase in *Polly Peck International Plc v Nadir (No 2)* [1992] 4 All ER 769 (CA) is simply out of place.
[52] Swadling (n 50 above).

liability is surprising in the law of wrongs and always requires explanation on special grounds, but, counter-intuitively, it is the natural response to unjust enrichment. The argument can never move forward if it is approached with the very familiar assumptions with which we always approach the law of tort. Unjust enrichment by nature gives rise to strict, though fragile, liability. While it is true that in a number of special situations a requirement of fault can serve a particular function,[53] a general denial of strict liability, or even a denial in a particular situation without reference to some special reason for the departure, is a denial of the very core of the law of unjust enrichment. The Supreme Court of Canada has indeed gone to that length in *Citadel General Assurance Company v Lloyds Bank Canada*.[54] With great respect, no comparative study of unjust enrichment could confirm that position. Liability in unjust enrichment is in principle strict.

The key is that unjust enrichment is first and foremost not about losses, and hence has nothing to do with the age-old dilemma of deciding which of two innocent parties should bear a loss.[55] The precise significance of the phrase "first and foremost" which is directly wired to the word "fragile," will be revisited immediately below. For the moment let the proposition stand without qualification that the law of unjust enrichment is not about adjusting losses but about relocating gains.

Suppose that you receive change for a £50.00 note when in fact you had paid with a £20.00 note. You are chatting to your friend and put the money in your purse without so much as looking at it. Before you reach the door of the shop they ask you to give back the surplus £30.00. It is no good you saying that they were very careless or that you were absolutely innocent. Fault on either side is irrelevant. The reason is that there is no question of making you bear a loss. You are only being asked to return a surplus that you were never intended to have.

The story can be made slightly more complex. Suppose that you were not stopped in the shop but crossed the road to the restaurant opposite to have lunch with your friend as originally planned. You pay the bill with cash. You are still completely unaware of the mistaken surplus, but in fact in paying the bill you use up all the notes in your purse. As you leave the restaurant, the people from the shop see you and ask you to return the surplus £30. Now you no longer have the notes, but the strength of the shop's claim is not one jot diminished. Your assets are still swollen to the tune of £30. You were going to have that

[53] This is discussed in P Birks "The Role of Fault in the Law of Unjust Enrichment" in GH Jones and WJ Swadling *The Search for Principle: Essays in Honour of Lord Goff of Chieveley* (OUP Oxford 1999) 235.

[54] [1997] 152 DLR (4th) 411 (SCC) 435. Cf also NJ McBride and P McGrath "The Nature of Restitution" (1995) 15 OJLS 33–49, answered by Lusina Ho "The Nature of Restitution—A Reply" (1996) 16 OJLS 517–533.

[55] Fears of strict liability invariably overlook this fact. Thomas (n 47 above) 249–251 endorses the *Akindele* rejection of strict liability but, though often not explicit, it is clear throughout her article that she is thinking in terms of allocating losses. Cf "Fundamentally, this is still a dispute about how to allocate the risk of loss for fiduciary fraud" (261).

lunch anyway. Had you not paid the bill with the cash in your purse you would have paid by credit card. You have spent the £30, but you still have surplus assets. Nobody is asking you to bear a loss, only to return the surplus which you were never intended to receive. Strict liability is the only appropriate rule. Unjust enrichment compels people to give up surplus assets which they ought not to retain.

The business of allocating losses is not encountered in these stories. Unjust enrichment is first and foremost concerned with extant unjust gains. However, it does encounter the problem of reallocating losses, as a further variation will show. Suppose that the original plan was to go home for lunch. Bidding good-bye at the bus stop your friend asks to borrow a couple of pounds for the fare. As you get it out, you find that you a have a bit more money than you thought. Still not suspecting the reason, you propose that since you seem to have some money to spare you will pay for lunch for both of you. You pay for the lunch, and then you are asked for the £30.00.

In this variation there is a loss to be borne. The shop is down by £30. You have spent, twice £20.00 less the cost of your home lunch, say £35 in all. And, though you have indeed had a good lunch, you would not have incurred expense but for being misled by the amount apparently at your disposition. Your assets are no longer swollen. There is no surplus to be returned. If you have to repay the £30.00, you will be worse off than you would have been but for the shop's mistake. You have changed your position.

After a change of position—a disenrichment induced by the enrichment[56]—fault does become relevant. The dishonest payee will not be able to set his disenrichment against the enrichment and will bear the loss. In English law it is not yet clear whether lesser degrees of fault will disqualify a recipient from the defence of change of position.[57] A clean rule that the honest may and the dishonest may not set off the disenrichment may be best. New Zealand experience shows that attempts at weighing and balancing the fault of both sides degenerate into an arbitrary guessing game.[58] "First and foremost" thus turns out to mean that, up until a change of position, unjust enrichment is solely about relocating gains. By the same token, until then liability is strict, but it is also fragile, because of the probable imminence of a disenriching change of position. Other defences, notably bona fide purchase, contribute further to this fragility, and the fragility renders illusory the fears of commercial uncertainty.[59]

[56] Whether there is any such thing as a non-disenriching change of position which will give a defence is very doubtful: further discussion in *English Private Law* (n 16 above) 15.308–309 and P Birks "Mistakes of Law" (2000) 53 CLP 205, 220–222

[57] "In our view, the honest, if foolish, defendant who, knowing all the facts, ought to have surmised that he should make restitution of the benefit conferred, should be allowed, in an appropriate case, to invoke the defence of change of position": Goff and Jones (n 28 above) 826.

[58] *Thomas v Houston Corbett & Co* [1969] NZLR 151 (NZCA); *National Bank of New Zealand v Waitaki International Provessing Ltd* [1999] 2 NZLR 211 (NZCA); RB Grantham and CEF Rickett *Enrichment and Restitution in New Zealand* (Hart Oxford 2000) 333–340.

[59] So, in all the variations immediately above, there would be no question of reaching the restaurant paid with the surplus £30, because it was a bona fide purchaser. In *Lipkin Gorman v Karpnale Ltd*

## 2 The Common Law Model

The unjust enrichment liability in question is illustrated at common law by the old case of *Holiday v Sigil*.[60] Holiday dropped a £500 note. Sigil found it. Holiday successfully maintained an action for money had and received against Sigil. *Moffatt v Kazana* is a modern example of the same configuration of facts.[61] It is tempting to say at once that *Holiday v Sigil* is no more than the old manner of demanding the restitutionary right triggered by the tort of conversion. We have already met the House of Lords' repudiation in *United Australia Ltd v Barclays Bank Ltd* of the notion that the bringing of an action for money had and received in respect of the proceeds of a wrong necessarily involved a switch to a cause of action other than the wrong[62]. On that view the cause of action will all along have been the wrong, not an unjust enrichment at the expense of the claimant.

However, the word "necessarily" needs to be emphasized.[63] There are many situations where a single set of facts will disclose more than one cause of action, as for instance in contract or in tort. In the same way there are situations in which a claimant may have more than one cause of action for restitution. And this is one. For we know from important modern cases that the claim exemplified in *Holiday v Sigil* will lie even though there is no wrong. In *Lipkin Gorman v Karpnale Ltd*[64] the claimant firm of solicitors successfully brought the modern equivalent of an action for money had and received against the casino in which a partner who had become addicted to gambling had gambled away money taken from one of the firm's accounts. In *Trustee of FC Jones & Sons v Jones*[65] the same kind of action was brought by the trustee of a bankrupt firm. The wife of one partner had invested some of the firm's money and had increased it fivefold. She was held to owe the firm the whole amount. In the former case the casino had not committed any tort at all. In particular it had not converted the firm's money. In the latter the Court of Appeal made no attempt whatever to identify any tort committed by the wife. Both are cases of strict liability for unjust enrichment.

[1991] 2 AC 548 (HL) had the gambler been addicted to good food his suppliers would have been immune for this very reason. It was only the nullity of the gambling contracts which deprived the recipient casino of this absolute defence (577).

60 (1826) 2 C&P 176, 172 ER 81.
61 *Moffatt v Kazana* [1969] 2 QB 152.
62 [1941] AC 1 (HL), discussed in text to n 19 above.
63 Burrows and McKendrick rightly point out that, if there is a flaw in the great *United Australia* case, it is that the House did not sufficiently make this emphasis: AS Burrows and E McKendrick *Cases and Materials on the Law of Restitution* (OUP Oxford 1997) 580. The argument that United Australia's first claim must have "waived the tort" was sufficiently answered by showing that no tort was waived and that the claim could well have been based on the tort. However, it would have been better to have drawn express attention to the possibility, in many fact situations, of a choice of cause of action in either tort or unjust enrichment.
64 [1991] 2 AC 548 (HL).
65 [1997] Ch 159 (CA).

*Holiday v Sigil* could no doubt be analysed as a case of restitution for the wrong of conversion. But it can also be analysed in the manner that explains these other cases in which there was no wrong. That analysis is as follows. The defendant becomes indebted to the claimant as in the old action for money had and received because the defendant is enriched at the expense of the claimant without the latter's consent. Cases of mistaken payment conform to the same analysis except that the consent is merely impaired by the mistake whereas in our situation there is absolutely no consent at all, since the transfer from the claimant happened without his knowledge. "Ignorance" seems to be the only word available to establish the parallel with mistake. The unjust factor is ignorance. Therefore the questions which establish a prima facie liability in unjust enrichment are answered as follows: (a)Was the defendant enriched? He was. The enrichment of the defendant is established with the aid of an election. The claimant elects not to insist on his pre-existing title. To insist on that title would be to assert that the asset was never added to the defendant's wealth. By contrast in treating it as having indeed enriched the defendant he accepts the fact of its having passed to him and abandons the contrary technicality. (b) Was it at the expense of the claimant? It was, for the asset was the property of the claimant. (c) Was the enrichment unjust in the sense of there being a reason for restitution other than either a manifestation of consent or a wrong? It was, for the claimant gave no consent to this acquisition at his, the claimant's, expense, not even the impaired consent which is given by a mistaken transferor. He was ignorant of the transfer.

Mr Virgo thinks this unjust enrichment analysis is wrong. He says that these claims have "nothing to do with the principle of reversing the defendant's unjust enrichment." They belong in the law of property and are examples of the "vindication of property rights." He says:

> "Unjust enrichment" in its substantive sense is completely irrelevant in this context, because the action to vindicate property rights forms part of the law of property and has nothing to do with the principle of reversing the defendant's unjust enrichment. Once it has been shown that the defendant has received or has retained property in which the plaintiff has a proprietary interest then nothing else needs to be proved to establish the plaintiff's cause of action. If the defendant has the plaintiff's property he or she should return it, or its value, to the plaintiff, without the plaintiff having to establish that the defendant has been unjustly enriched at his or her expense.[66]

He goes so far as to deny that the leading case on unjust enrichment was a case on unjust enrichment:

> If this analysis is correct we are left with a nice irony. Whilst the decision of the House of Lords in *Lipkin Gorman v Karpnale* is of prime importance as the case in which the unjust enrichment principle was accepted as forming part of English law, that case is not itself authority for the application of the unjust enrichment principle on the facts of the case.[67]

[66] Virgo (n 6 above) 12.
[67] Virgo (n 6 above) 14–15.

This ignores the difference between vindication and the protection of property rights through the law of obligations (which might, somewhat riskily, be called indirect or parasitic vindication). The *Lipkin Gorman* case was not a *vindicatio*. The common law has no such thing. It was a personal claim asserting an obligation of the defendants to pay the value of what they had received. In the language of the forms of action it was an *indebitatus assumpsit* brought on the ground that the defendant casino had received money to the claimant's use. In short, it was, or would in the old days have been, an action for money had and received. "Money had and received" was, as Lord Mansfield said, money "which ought not in justice to be kept."[68] The defendant casino had incurred a debt arising from the receipt of money which ought not in justice to be kept—that is, from unjust enrichment.

*Lipkin Gorman v Karpnale Ltd* is exactly what the House of Lords said it was. Like *Holiday v Sigil* before it, it shows that one indirect or parasitic way of protecting property is to treat the defendant as having incurred an obligation arising from unjust enrichment. Though less familiar, this is structurally identical to treating him as having incurred an obligation from a wrong—from the wrong to which we are giving the generic name "misappropriation". At common law one cannot vindicate. One has to turn to the law of obligations. And within the law of obligations one turns either to an obligation arising from a wrong or, more rarely, to an obligation arising from unjust enrichment.

## 3 Lionel Smith's Rejection of Strict Liability in Equity

Professor Lionel Smith's position in relation to this kind of claim has a superficial similarity to that of Mr Virgo in that he now uses the term "title claim" and insists on the separate treatment of such claims.[69] However, his stance is actually quite different. He does see these claims as claims in unjust enrichment. His "title claims" are a subset of claims in unjust enrichment, to be separated from and contrasted with cases of enrichment by transfer.[70] Smith thus introduces to the common law a distinction almost identical to the Wilburg-von Caemmerer distinction which is embedded in the para 812 BGB. That paragraph distinguishes between enrichment through a *Leistung* (a performance) and enrichment in some other way. The interpretation of "some other way" then gives most of its territory, though not all, to the *Eingriffskondiktion*—the claim made against one who has enriched himself by an encroachment upon a right, typically a proprietary right, which attributes wealth to another.[71]

[68] *Moses v Macferlan* (1760) 2 Burr 1005, 1112; 97 ER 676.
[69] Smith (n 2 above) 412
[70] Smith (n 2 above) 421–425.
[71] G Dannemann in B Markesinis W Lorenz and G Dannemann *The German Law of Obligations Volume I The Law of Contracts and Restitution: A Comparative Introduction* (OUP Oxford 1997) 717, 740; R Zimmermann and J du Plessis "Basic Features of the German Law of Unjust Enrichment" [1994] Restitution L Rev 14, 24.

The very fact that German jurisprudence has accepted the need for this bifurcation of the law of unjust enrichment means that one must hesitate to minimize its importance and pause still longer if one is tempted to say that the bifurcation is unnecessary. However, it seems to me that it is indeed unnecessary except as a sub-theme in the discussion of the phrase "at the expense of the claimant". Professor Burrows also says that the two kinds of claim identified by Smith are "essentially the same."[72]

Those who can be said to have been enriched at the expense of the claimant divide between the direct or immediate enrichees and secondary or remote enrichees. The general principle, subject to exceptions, is that one cannot leapfrog the immediate enrichee so as to sue a remote enrichee.[73] It is often attractive to try to do so, since the remote enrichee may have a longer purse than the immediate enrichee. In seeking out the exceptions to the rule against leapfrogging, there is no doubt that the most obvious are constituted by these *Lipkin Gorman* claims, called "title claims" by Smith.[74] If C drops a £50 note and X picks it up and gives it to D, C can sue D leapfrogging X. *Lipkin Gorman v Karpnale Ltd*, although it encounters serious complications arising on its own facts, indubitably accepts this proposition. That has to be explained.

The truth underlying the "exception" may be that it is not an exception at all but rather a reflection of the fact that D has exactly the same relationship to C as has X. That is to say, if that which is received is the property of C and remains the property of C, every subsequent recipient is enriched directly from C. X and D are both immediate enrichees from C, despite the distracting physical fact that D received from X. He received C's property and therefore enriched himself directly from C.

Since leapfrogging is a very important matter any discussion of "at the expense of the claimant" must dwell on this phenomenon, be it exception or be it not. But nothing suggests that the law of unjust enrichment therefore needs to be divided into two very different parts, as Smith would want to have it.

This is all the more apparent when account is taken of the fact that Smith, differently from German law, would separate from enrichment by transfer only the second and subsequent recipients.[75] In *Holiday v Sigil* the claimant was the person who lost the note and the defendant was the first finder. Smith would count that as a case of enrichment by transfer. It is only when the first finder, or taker, passes on to another that Smith sees the need to pass from one half of his bifurcated law of unjust enrichment to the other. This highlights the essential triviality of the line between the two halves, for, in the inquiry under "at the

[72] Burrows (n 15 above) 417 n 29.

[73] Professor Burrows gives this principle the name of "privity," a word somewhat unhappily retained from the day in which the law of unjust enrichment was compelled to live within contract, under the fiction of "implied contract." That word aside, his treatment is the best that is currently available: AS Burrows *The Law of Restitution* (Butterworths London 1993) 45–54.

[74] Burrows (n 73 above) 48–49.

[75] Smith (n 12 above) 426.

expense of," the next finder or taker or the next recipient from the first finder or taker will indeed be in a position identical to that of the first finder or taker: he will have received that which was the property of the claimant.

The question under "at the expense of" is simply whether, without relying on the facts in their character as a wrong, it is possible to say that the defendant was enriched "from" the claimant. "From" is open to broader and narrower interpretations, amongst which every system has to make its choices. Then comes the question of directness. It must in principle be "directly from" the claimant. It is easy to conclude that those who receive valuable assets which are the property of the claimant are always and equally enriched directly from the claimant.

At this point we have done no more than to argue that at common law there is a straightforward personal claim in unjust enrichment against one who receives money or valuable assets belonging to another without that other's consent. This claim lies alongside the structurally similar, and more familiar, claim in tort. According to the presumption which we set up at the beginning that same regime should apply equally to property held behind the curtain of a trust. In other words equitable owners should have the same protections as legal owners, and all the more so now that so much wealth stored in the form of financial securities is held by custodian trustees. When Lord Nicholls very powerfully argued that equitable owners should indeed have the benefit of an equitable equivalent of the *Lipkin Gorman* claim,[76] it seemed only a matter of time until that position would be made secure in the courts.

The outlook has become less clear. The real importance of Lionel Smith's article in the present context is that he argues that, since equitable property has a different history and different incidents, equitable "title claims" in unjust enrichment must be allowed and indeed expected to be differently protected.[77] He thinks that one of these differences is precisely that the equitable owner has no personal claim in unjust enrichment. He has the *vindicatio* and he has the personal claim for the wrong of misappropriation, but he has nothing parallel to the *Lipkin Gorman* claim in unjust enrichment. This position has been endorsed by Susan Thomas.[78]

This contention has to be taken very seriously. The slightest suggestion that equitable owners are less well protected than legal owners is these days likely to chill the heart of the City of London. We noticed above that one consequence of the new market mechanisms is that investors by and large now take equitable interests in securities, the legal title being held by some giant intermediary. The kind of argument which Professor Smith advances, that equitable ownership is somehow second class and protected in a second class manner, will create real

[76] Lord Nicholls (n 1 above).
[77] Smith (n 2 above) 412, esp 430 ff. Cf K Barker and L Smith "Unjust Enrichment" in D Hayton (ed) *Law's Futures* (Hart Oxford 2000) 411, 424–426.
[78] SB Thomas (n 47 above) 251–253.

anxiety and, if it goes much further, will obstruct or distort the development of the new market mechanisms. The first step therefore is to underline the fact that in practice few cases would be decided differently in a world which failed to accept the equitable owner's strict personal claim in unjust enrichment.

One aspect of the illusory fear of commercial uncertainty which we have already discussed is that, if we supposed that Lionel Smith were right that there is no unjust enrichment claim in equity and that knowing receipt must retain its character as a fault-based wrong, the one recipient of trust assets who would definitely be treated differently would be the innocent donee who has not changed his position but is no longer in possession of the thing received or its traceable substitute. Donees—relatives, lovers, charities, political parties—are not a wholly insignificant group and they are not a group which is usually much protected in competition with plundered owners.

Such a recipient, if innocent, could not be made liable in Lionel Smith's world. Suppose that D has innocently received £1000 from X and Y, who took the money from a trust fund of which they were trustees. D uses that money to pay his rent, which he would have had to pay anyhow and would have paid with money from his bank account. There is nothing left to vindicate. D cannot be sued for the wrong of misappropriation (knowing receipt) because the fact is given that he was innocent. He would be liable in unjust enrichment, but in Lionel Smith's world the beneficiaries under the trust would have no such claim.[79] Lord Nicholls' earlier paper had quite rightly repudiated that conclusion.[80] Only legal owners would have the *Lipkin Gorman* kind of claim.

Apart from this figure—the donee with nothing left of that which he received but unable to point to a change of position—the only people whose cases would come out differently would owe that difference to the altered onus of proof. The fault-based liability requires the claimant to prove fault; the unjust enrichment liability is strict but defeated by bona fide change of position and bona fide purchase. The defendant bears the onus of proving the ingredients of defences. In a rare case a defendant against whom fault could not be proved might nevertheless be unable to shift the onus of proving his own good faith.

Lionel Smith does, however, have one very good argument. There are almost no cases allowing an unjust enrichment claim of the *Lipkin Gorman* kind to an equitable owner. It would be startling, he says, to have to conclude that all the judges and lawyers had been blind to the possibility.[81] In this field, however, there are three reasons why that should not be decisive.

First, the law of unjust enrichment has only just come into the light.[82] It is not only in this area but across the board that it has been hidden or distorted. The

[79] Smith (n 2 above) 432.
[80] Lord Nicholls (n 1 above) 236–237.
[81] Smith (n 2 above) 413, 430, 435
[82] The beginning of this change can be dated to 1933 or 1966, the former because in the USA the *Restatement of Restitution* was commissioned in that year, the latter because it marked the publication of the first edition of *Goff and Jones on Restitution* (n 28 above): for a short account of the

tensions and ambiguities in the case law on knowing receipt are themselves an indication of the call of more than one mission and, as such, are evidence of unjust enrichment seeking to establish a foothold in this territory.

Secondly, it is not acceptable any longer to refuse to take account of common law cases when seeking to establish principles to apply in equity. There is one body of law. If the common law cases show that an owner whose assets fall into alien hands ought to have a claim in unjust enrichment, that conclusion ought to carry over to equitable owners unless there is some hard reason why not.

Thirdly, whatever the historical and analytical peculiarities of the *Re Diplock* claim,[83] the fact remains that those entitled under a will or an intestacy do have a claim of the *Lipkin Gorman* kind against those to whom the estate is misdirected. The misdirectees are liable personally, without regard to fault. Their liability fits neatly within the modern law of unjust enrichment alongside *Lipkin Gorman v Karpnale*. This makes it quite intolerable that beneficiaries under an inter vivos trust should have no such claim. Taken in conjunction with the prima facie unreasonableness of excluding the equitable owner from the law of unjust enrichment, this is the kind of argument that history cannot win. History has produced an anomalous present. The only acceptable thing to do is to overwhelm the anomaly by extending to beneficiaries under a trust the same kind of claim as is available both to legal owners and to beneficiaries under a will or intestacy.

Other arguments advanced by Lionel Smith are less good. He says that those who would extend to equitable owners an equitable claim in unjust enrichment parallel to that available to legal owners are in effect arguing for the abolition of the trust and doing so precisely at the time at which the trust is drawing to itself more and more business and is therefore the envy of other jurisdictions.[84]

There is nothing in that point. To strengthen the protection of the beneficiary is not in any way to undermine the institution of the trust. In fact Chancery has always laboured to ensure that beneficiaries should be invulnerable. That is why, in relation to land, there are so few cases in which the defence of bona fide purchaser has destroyed an equitable interest. When land was the principal store of wealth, the judges made it almost impossible to satisfy the terms of the defence. In fact, even now, in the light of all the new developments in the financial markets, the best service to the trust would, once again, be to ensure that the beneficiary, though an owner in equity and not in law, was not in any way a second class owner.

He also says that there would be a tension or contradiction between the fault-based wrong of misappropriation and a strict liability in unjust enrichment.

modern history of the subject: P Birks "The Law of Restitution at the End of an Epoch" (1999) 28 UWA L Rev 13, reprinted in LD Smith *Restitution* (Ashgate-Dartmouth Aldershot 2000) 83.

[83] *Minister of Health v Simpson* [1951] AC 251 (HL), *Re Diplock* in the courts below. Smith (n 2 above) 437–444. By common consent this claim would now be subject to the defence of change of position, and the notion that the executors should bear the primary liability would also now be rejected. On the latter point, see especially P Creighton and E Bant (n 3 above) 228–230.

[84] Smith (n 2 above) 430–432.

That is not so. As we have seen some minor readjustment might be needed to minimize the degree of conflict between the two kinds of claim, but that involves no more than fine tuning. Otherwise there would be a familiar situation of concurrence, in which some claimants would be able to analyse their facts so as to reveal alternative causes of action, with one in wrongs and one in unjust enrichment. Concurrence always implies a degree of contradiction between the competing actions.[85] The liability in unjust enrichment is strict but fragile. Its primary purpose is to ensure that swollen assets—or more accurately the swelling in the assets—in the wrong hands should be returned, however innocently received. It in effect merges with the fault-based liability as against a defendant who has no continuing swelling in his assets. That is the effect of disqualifying the dishonest recipient from pleading the defence of change of position.

The real contradiction lies elsewhere and works the other way. It is virtually impossible to defend the vindication of substitute assets without accepting the necessity of admitting the strict personal claim in unjust enrichment. We have seen that the vindication of substitute assets is probably best explained in terms of unjust enrichment. If I exchange your trust money for a car, your rights in the car derive from the fact that, in me, the car is an unjust enrichment from you—that is, from your money. Smith himself agrees with this.[86] Those who do not agree find it very difficult to put forward any reason at all why we do allow the vindication of substitute assets. There seems to be no other reason.

If one is once driven to accept the explanation of substitution in terms of unjust enrichment, one then encounters an irresistible force in favour of the *Lipkin Gorman* kind of claim. The argument focuses on the example already given. Innocent D receives trust money and pays his rent with it. He would have paid it anyhow. His assets are still swollen. In the absence of the personal claim in unjust enrichment he cannot be made liable. He has not committed the wrong of misappropriation, and there is nothing to vindicate.

Had D bought a car with the trust money his position would be quite different. There would be a *vindicatio* of the car. Evidently D's liability turns upon the chance of how he happens to use the trust money. It should not. Unless there is some altogether different explanation of the nature and effect of substitution, it should depend on whether he still has swollen assets. It makes no sense to suppose that the case in which he does still happen to have traceable assets is the one case in which he is still sitting on swollen assets. He may have some traceable substitute but no continuing swelling of his wealth as a whole, or he may have no traceable substitute but still be holding more than he should be.

[85] Cf *Henderson v Merrett Syndicates* [1995] 2 AC 145 (HL). The problems of concurrence are excellently discussed in AS Burrows *Understanding the Law of Obligations* (Hart Oxford 1998) 16–44.

[86] Smith (n 2 above) 424–5.

A rational and consistent position cannot be brought about without two steps being taken. One is that the *vindicatio* of the substitute must itself be subject to the defence of change of position, to allow for the possibility that, though D does indeed hold a traceable substitute, he may have changed his position collaterally and thus have no swelling in his assets. Suppose, for example, that having used the trust money to buy a car, he then threw a huge party which he would not have thrown but for feeling better off because of the arrival of the trust money. The other, which copes with the situation where D holds no traceable substitute but has not changed his position, is to allow the beneficiaries under the trust an equitable claim of the *Lipkin Gorman* kind.

## D CONCLUSION

These arguments suggest that if *Re Montagu* were now replayed, Megarry V-C's view that the liability for the wrong of knowing receipt required proof of dishonesty might survive, despite intervening hardening of the other opinion, namely that it only involves non-intentional fault in the form of failure to make the reasonable inquiries. However, that option for dishonesty would only be taken because in the meantime it had become apparent that a claimant in the position of the eleventh Duke was entitled to a claim in unjust enrichment parallel to that which was recognized for legal owners in *Lipkin Gorman v Karpnale Ltd* and which, in the same way as that claim, was based on strict liability subject to vigorous defences. Lord Nicholls' study of this subject shows unequivocally that such a claim cannot be denied. This chapter was all along unnecessary and would not have been written but for the challenges subsequently made to his position, above all that of Professor Smith. The sooner the matter reaches the House of Lords the better. It has to be sorted out. Very important practical consequences attach to the difference between the liability in unjust enrichment and the liability in wrongs. The latter is immune to the defence of change of position. The former can never reach consequential losses. Such things cannot be left in continuing uncertainty.

At a certain level Professor Smith can claim to have the cases on his side. But authority cannot militate indefinitely against reason, and there is no rational argument for depriving the equitable owner of the claim in unjust enrichment based on strict liability. So long as he remains so deprived, equity will be seen to defy the fundamental principle of that cause of action, namely that while a person's wealth remains unjustly swollen the liability to make restitution is utterly independent of fault. There is no argument for keeping what one was never intended to have. After an honest change of position things begin to look different. Chancery cannot defy the principle. Nor has it defied it so much as failed to understand it. And here and there, in its position in relation to substitution of one asset for another and in relation to misdirections from

the estates of deceased persons, it has accepted it, albeit intuitively and still without fully comprehending it. There is nothing surprising in that story, for in the common law countries the law of unjust enrichment is only just beginning to be understood.

# 8

# *Exemptions*

JE PENNER

THE DECISION OF the Court of Appeal in *Armitage v Nurse*,[1] given by Millett LJ, is undoubtedly a landmark for the law governing trustee exemption clauses. While there have been subsequent relevant decisions,[2] it is the forcefulness and analytic clarity with which Millett LJ's decision undertakes to state the fundamental principles at work which makes it so important. Millett LJ's decision now stands as the background position of the common law (meaning here to include equity of course) on this matter, and so any legislation must be read in light of what this position is, to determine what changes to the law any legislation actually provides, and what underlying concepts and conceptual framework of analysis survive any such legislative programme. *Armitage v Nurse* will serve as that reference point until we have a serious discussion of the issues in the House of Lords.

As I shall argue, however, the reasoning in *Armitage* flows from a way of understanding trusts in which the "obligational" aspect of the trust is emphasised over its "proprietary" aspect. These terms are undoubtedly mysterious at this point, but following a critical examination of the decision in *Armitage*, I shall try to give some substance to them and show why the emphasis on the former aspect has significant consequences for our appreciation of the limits of trustee exemption clauses.

## A THE FACTS IN *ARMITAGE*

The appellant, Paula Armitage, brought an action for breach of trust against her trustees. Her interest in the trust arose as the result of a variation of a preceding settlement under the Variation of Trusts Act 1958. At the time of variation, Paula's mother was the life tenant and Paula, then 17, the remainderman.

[1] [1998] Ch 241. Leave to appeal was refused by the House of Lords on 18 December 1997 [1998] Ch 264.

[2] *Bogg v Raper* The Times 22 April 1998 (CA); *Wight v Olswang* The Times 18 May 1999 (CA); *Walker v Stones* [2001] 2 WLR 623 (CA); all have these have followed in all essential respects the decision in *Armitage*.

The effect of the variation was to partition the trust property so as to give Paula's mother an absolute interest in a portion of land plus a lump cash sum. A portion of land plus a smaller sum, was resettled upon Paula, (1) to accumulate the income until Paula attained the age of 25, whereupon her interest in the income would vest absolutely, with power to pay or apply the income for her benefit in the meantime; and (2) as to capital, on trust for Paula contingent upon her attaining 40, with a provision for transferring the capital in instalments between the ages of 25 and 40.

The land (both Paula's and her mother's) was largely farmland. Prior to and after the variation the land was farmed by a family company, whose sole shareholders and directors were Paula's mother and grandmother. Thus, following the variation, the trustees contracted for Paula's farmland to be farmed by a company controlled by her mother, who had been beneficiary, with Paula, of the preceding settlement. The gravamen of Paula's complaint was that following the variation, her trustees dealt with her land not with her interests solely, or even largely in mind, but so as to benefit her mother and other members of the family.

Before proceeding further, it is worthwhile considering the plausibility of Paula's complaint. It would seem to me that Paula's complaint is all too plausible. Here we have a situation where a large family farmholding is held on trust over several generations. A resettlement is proposed for various worthy reasons, as a result of which only one of the previous main beneficiaries, a minor at the time, continues to hold her interest in the "family operation" under a trust. But to the trustees of this new trust, it might well appear that this is merely a "technical" rearrangement. Things are to go on basically as before. All the land continues to be farmed by the same family company under the direction of the same principals. In particular, it is easy for the trustees of the new settlement not to appreciate that, whatever their thoughts were as to their duty to hold an even hand between the life tenant and the remainderman under the old settlement, their duties in this respect have now fundamentally changed, as they are now to further single-mindedly the interests of one person who for all intents and purposes (assuming she attains the ages specified under the trust, ie, the gifts over on her early death do not take effect) is the only beneficiary of the new trust.

Two of Paula's particular allegations against her trustees were that they failed properly to supervise the company's management of her land, and that they failed to inquire into the reason or reasons why, when both Paula and her mother sold their respective parcels of land received under the partition upon variation, hers had substantially declined in value from the figure at which it was valued at the time of the partition while her mother's had appreciated. If we assume, as also seems plausible, that Paula's mother was a dominant force in the family, then it would seem very plausible indeed that the trustees might have wished to avoid any family friction that might be caused by their challenging the general running of the farm by the family company or by their inquiring into the possible sources of the sale values of the different parcels of land, or into

the circumstances of the valuation of the different parcels at the time of variation and the basis of the decision to partition the land in the way it was partitioned.

## B THE VALID SCOPE OF TRUSTEE EXEMPTION CLAUSES

Before preceding to trial, a preliminary question arose as to the validity and scope of the exemption clause in the trust instrument, and it was this question which formed the core issue of the appeal. Clause 15 of the trust was in the following terms:

> No Trustee shall be liable for any loss or damage which may happen to Paula's fund or any part thereof or the income thereof at any time or from any cause whatsoever unless such loss or damage shall be caused by his own actual fraud . . .[3]

Millett LJ's decision covered a number of points, and can be summarised as follows:

(1) The words "actual fraud" effectively exclude the broader concepts of fraud found in "constructive fraud" or "equitable fraud" to the extent these terms have been applied to include mere or gross negligence. Thus the clause effectively exempts the trustee from any liability from acts which are not actually fraudulent. In the case of trustees, actual fraud denotes actual dishonesty, either acting in a way they know to be contrary to the interests of the beneficiaries or in reckless indifference to their interests; this is not co-extensive with deliberate breach of trust:[4]

> By consciously acting beyond their powers (as, for example, by making an investment which they know to be unauthorized) the trustees may deliberately commit a breach of trust; but if they do so in *good faith and in the honest belief that they are acting in the interest of the beneficiaries their conduct is not fraudulent*. . . . It is the duty of a trustee to manage the trust property and deal with it in the interests of the beneficiaries. If he acts in a way which he does not honestly believe is in their interests then he is acting dishonestly. It does not matter whether he stands or thinks he stands to gain personally from his actions. A trustee who acts with the intention of benefiting persons who are not the objects of the trust is not the less dishonest because he does not intend to benefit himself.
>
> In my judgment cl 15 exempts the trustee from liability for loss or damage to the trust property no matter how indolent, imprudent, lacking in diligence, negligent or wilful he may have been, so long as he has not acted dishonestly.[5]

In the context of trustee exemption clauses, "wilful default" will bear the same meaning as "actual fraud."[6]

[3] *Armitage* (n 1 above) 250.
[4] *Armitage* (n 1 above) 250–51.
[5] *Armitage* (n 1 above) 251 (my italics).
[6] *Armitage* (n 1 above) 252.

(2) A clause such as clause 15 will not assist the trustee in cases where he has committed "equitable fraud" where that denotes "some dealing by the fiduciary with his principal and the risk that the fiduciary may have exploited his position to his own advantage".[7] There is no "loss or damage" to the trust[8] in these cases; rather, such transactions are liable to be set aside (or equitable compensation claimed) irrespective of any loss or gain to the principal; thus, a self-dealing transaction is liable to be set aside even if the purchasing trustee pays more for the property than it is worth.

(3) A clause such as clause 15 is not repugnant to the trust:

> There is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient. . . . [A] trustee who relied on the presence of a trustee exemption clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term.[9]

There are a number of issues raised by these findings of law,[10] but I shall concentrate on the one which, it is submitted, is the most important for determining the correctness of the decision: Millett LJ's characterization of the irreducible core of trustee obligations.

## C THE DUTY OF LOYALTY AND THE FIDUCIARY OBLIGATIONS OF A TRUSTEE

At first glance, Millett LJ's decision may appear to be misleading. If one assumed that Millett LJ had intended that his characterisation of the trustee's obligation to perform the trusts in good faith and only in the interests of the beneficiaries was essentially just another formulation of a trustee's fiduciary obligation, then Millett LJ could be taken to be advancing, as a basic proposition, that the trustee's core obligations included his fiduciary obligations. Millett's statement quoted in support of point (1) above, where he frames the trustee's duty of good faith as a duty to serve only the best interests of the beneficiaries, may seem to support this interpretation, as well as might the following passage which underlies point (2) above, ie:

[7] *Armitage* (n 1 above) 253.

[8] *Armitage* (n 1 above) 253.

[9] *Armitage* (n 1 above) 253–54.

[10] Two are Millett LJ's support , *Armitage* (n 1 above) 252, of Maugham J's characterization of wilful default in *Re Vickery* [1931] 1 Ch 572, and his characterization of the common law's scepticism of or inability to make clear sense of a distinction between ordinary and gross negligence, *Armitage* (n 1 above) 254–56.

[a] trustee exemption clause such as clause 15 of the settlement does not purport to exclude the liability of the fiduciary in such cases [ie, cases of breach of fiduciary obligation such as self-dealing].

That Millett LJ found that there was no question of repugnancy of clause 15 on the ground that the clause excluded liability for breach of fiduciary obligations of this kind could be interpreted to mean that such a provision *would be* "repugnant" if it had excluded liability for these kinds of breaches.[11]

However, read as a whole the decision cannot bear this interpretation. A few sentences further on in the judgment, Millett LJ said, "[b]ut it is unnecessary to explore this further, for no such conduct is pleaded," and thereafter Millett LJ attended only to the issue of whether the trustee had acted dishonestly so as to be unable to rely upon clause 15. Since, as has often been emphasized, a fiduciary obligation can be breached without any dishonesty, can be breached even in the best of faith,[12] it would be a mistake to read Millett LJ as treating the duty of honesty and the fiduciary obligation as equivalent. Furthermore, since Millett LJ ultimately based his decision on the valid scope of limitation clauses upon the core duties of the trustee, it would not have been supportable to base the decision upon some standard of fiduciary duty, for not all trustees are subject to fiduciary obligations in their dealings with trust property. This was accepted by the Privy Council in *Hayim v Citibank NA*.[13] In *Kelly v Cooper* the Privy Council said that "the extent and nature of the fiduciary duties owed in any particular case fall to be determined by reference to any underlying contractual relationship between the parties," and it is submitted that the same reference to the particularity of the arrangement applies to the case of trusts as well.[14] It would not appear that there is any scope for fiduciary obligations in

[11] With respect to "repugnancy," whether the result of the inclusion of such an exemption clause in a trust instrument would result in the transaction being held valid as a transaction of some kind, but not a trust, or whether an intention that there was to be a trust was dominant, such that the exemption clause would be read down or struck down as being inconsistent with or "repugnant" to the main thrust of the transaction, would be a matter of construction.

[12] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378, [1967] 2 AC 134n (HL); *Boardman v Phipps* [1967] 2 AC 46 (HL).

[13] [1987] AC 730 (PC).

[14] It is famously difficult to define fiduciary obligations, but without arguing the point in detail here, the basis for arguing that not all trustees are fiduciaries is that not all trustees have discretions in exercising their legal powers over the trust property in such a way that they have scope for action which could favour the interests of themselves or others over the interests of the beneficiaries. I am therefore, adopting without a sustained argument, the "discretion" theory of fiduciary obligations. See EJ Weinrib "The Fiduciary Obligation" (1975) 25 *University of Toronto Law Journal* 1; P Birks, "Equity in the Modern Law: An Exercise in Taxonomy" (1996) 26 *Western Australian Law Review* 1, 18; J Langbein "The Contractarian Basis of the Law of Trusts" (1995) 105 *Yale Law Journal* 625, 655–59. The force of the discretionary theory lies in its pointing out that in certain legal arrangements, the essence of the arrangement is that one person, the principal, relies on the expertise or the capacity for action of another, the fiduciary, and it is impossible to specify in advance how that expertise or capacity for action ought to be exercised, besides simply requiring that it be exercised for the benefit of that other. If the law is to allow such arrangements (and there would appear to be no obvious reason why it should not) then the fiduciary must take the interest of the other to be the sole guiding consideration in his exercise of his discretion. Otherwise, the arrangement simply will

not work; that is, if the law will not recognise that such a duty can be undertaken, then this discretion-conferring undertaking cannot operate, for it would not serve the advantage of A to confer a discretion upon B to affect A's position if B could not be required to exercise that discretion solely in A's best interests. Therefore, if the law wishes to provide for this sort of arrangement, it must impose fiduciary obligations where this sort of arrangement is entered into. According to this theory of fiduciary obligations, a fiduciary duty can be strictly defined as the duty of the fiduciary to exercise a discretion solely in the best interests of his principle, in circumstances where one person, the fiduciary, has agreed to undertake *legal* powers to affect the *legal* position, *ie*, *the legal rights, duties or powers*, of another, the fiduciary's principal, and the fiduciary has a discretion in the way he will exercise those legal powers (*legal* here meaning recognised by law, so meaning *legal and/or equitable* powers). The two central cases are that of the typical trustee and his beneficiary, and the agent and his principal. A trustee has the legal title to the trust property, and therefore has the legal power to affect the position of the beneficiary. To the extent he may exercise that power with any discretion, he has a discretion to alter the legal rights and duties of the beneficiary. He buys and sells trust property in the course of exercising his discretion to invest the trust fund; he may have a discretion under the trust instrument to pay one beneficiary more than another; he may have the power to select successor trustees. In exercising those powers, he must bear only the beneficiaries' interests in mind. He should not buy company shares as an investment because he has an interest in the company and thinks it needs more capital; he should not exercise his discretion to give beneficiary X a great deal and beneficiary Y nothing because he is in love with beneficiary X; he should not appoint his brother as his successor trustee because his brother is down on his luck and could do with the trustee's fees. Similarly, an agent is someone who is empowered to make contracts for his principal with third parties, and must similarly act in consideration only of the best interests of his principal. He should not, for example, sell his principal's goods to a third party because the third party is willing to "kick back" part of the purchase price to him. The crucial point is that a fiduciary is one who voluntarily undertakes to act as a *decision-maker* for someone else: the fiduciary is empowered to make decisions (legally *binding* decisions) for his principal's benefit (decisions which, therefore, alter the principal's *legal* position). While these are the classic cases of fiduciary relationship, the concept has been stretched to cover other cases, sometimes appropriately—eg, to the case of the solicitor, for while a solicitor does not necessarily have true legal powers to affect his client (he does not necessarily act as the client's agent, strictly speaking), the solicitor does typically advise his client how to deal with third parties in circumstances where the client essentially follows the solicitor's advice, and so in that sense the solicitor has strong practical powers to affect his client's legal position vis-à-vis those third parties—sometimes not. Perhaps the oddest extension of the concept is found in the decision of the Canadian Supreme Court in *M(K) v M(H)* [1992] 3 SCR 6, (1992) 96 DLR 4th 289 (SCC), where a father was found to have breached his fiduciary obligation to his child by sexually abusing her. (See also *Norberg v Wynrib,* [1992] 2 SCR 226, (1992) 92 DLR 4th 449 (SCC)). Now child abuse is a dreadful wrong, and when a parent commits it against his child it is also, in a general sense, a terrible breach of loyalty and good faith. But child abuse is a crime and a civil wrong. No one has a legal power or discretion to commit child abuse, one which should be exercised in good faith or not at all. Fiduciary obligations are intended to ensure that a fiduciary takes decisions *which he is otherwise legally empowered or obliged to undertake in one way or another under his trust or agency or retainer* in a manner which best serves the interests of his principal. In view of a fiduciary's fiduciary obligations, an otherwise *legitimate* use of a *legitimate* power or discretion may be *turned into* a wrong, because it reveals a breach of loyalty or good faith. A breach of any old obligation, whether the commission of a tort like assault or child abuse, or a breach of contract, does not become a breach of a fiduciary obligation simply because, besides being wrong in its own right, it *also* reveals self-interested disloyalty or bad faith on the part of the perpetrator; those acts are not within the range of decisions which make up the extent of any fiduciary's discretion, to which, and only to which, the fiduciary's fiduciary obligations apply. Thus if your trustee favours his own interests over yours by beating you up or slandering you or stealing your bicycle he certainly commits a wrong, but does not breach his fiduciary obligations to you (although because he is a fiduciary to you in respect of some of your affairs it might be particularly unseemly on his part to commit such a wrong, and this might rightly be regarded as an aggravation of the tort). Nevertheless, as in *M(K) v M(H)*, courts appear to have occasionally stretched the concept of "fiduciary" in just this way as a means to deal more effectively with a wrongdoer.(Another example is *Reading v A-G* [1951] AC 507 (HL); see G Jones "Unjust Enrichment and the Fiduciary's Duty of Loyalty" (1968) 84 LQR 472.) In short, the mere commission of a wrong does not become a breach

pure bare trusts,[15] nor in *Quistclose* trusts[16], which of course is not to say that the trustees of such trusts could not commit a fraudulent breach of trust. But a fraud is not equivalent to a breach of fiduciary obligation, even in the case of a trustee.

Even so, given the facts of the case and the scope of clause 15 as found by Millett LJ, it did not seem appropriate for Millett LJ to narrow his focus so stringently to dishonest or actually fraudulent behaviour. Millett LJ examined the pleadings in the case and found that none clearly alleged dishonesty, but at most, negligence, and therefore the trustees were not liable. Millett LJ did allow the plaintiff to re-amend her pleadings, but added:

> I express no view on whether there is material which would justify counsel in advising such a course; and I would not wish to encourage it. They will no doubt bear in mind that at the material time the trustees of the settlement consisted of one professional man and two distant relatives; and that a charge of fraud against independent professional trustees is, in the absence of some financial or other incentive, inherently implausible.

But, if clause 15 did not relieve the trustees of liability for breach of their fiduciary duty to act only with the best interests of their beneficiary in mind then in so far as Paula's case could be understood as a claim of this kind, clause 15 could not assist the trustees. As mentioned above, a breach of fiduciary obligation could be regarded as the essence of Paula's complaint, and as also mentioned, it was a plausible claim on the facts. In order to see how strongly Paula's claim might have been made, consider in comparison the duty of evenhandedness. The duty of even-handedness must be regarded as one of the trustee's fiduciary obligations for only by being even-handed between the beneficiaries does a trustee meet his obligation of good faith and loyalty to *all* the beneficiaries. Indeed, the duty of even-handedness is just a specification of the duty of loyalty

of fiduciary obligation just because it shows that the wrongdoer favoured his own interest over that of the person he wronged, for that would turn most torts and breaches of contract into breaches of fiduciary obligations; there must be a previously constituted fiduciary relationship by which the fiduciary is empowered to make legally binding decisions which affect his principal, and he breaches a fiduciary obligation when he makes a decision *which he was otherwise entitled to make within the scope of his discretion*, but which reveals that he favoured his own interests over those of his principal.

[15] The self-dealing rule does not, apparently, apply to bare trustees (see DJ Hayton *Underhill and Hayton's Law Relating to Trusts and Trustees* (15th edn Butterworths London 1995) 653, and J Mowbray et al *Lewin on Trusts* (7th edn Sweet & Maxwell London 2000) para 20–78. Against this view lies the decision of Cross J in *Re Brooke Bond &Co Ltd's Trust Deed* [1963] Ch 357, where a managing trustee decided in good faith to take out a trust insurance policy with the custodian trustee in its capacity as an insurance company. Cross J held that such a transaction was prohibited as being made by the custodian trustee in conflict of interest, even though the managing trustee had made the decision and the custodian trustee had no discretion to make the policy with itself. It is submitted that *Re Brooke Bond's Trust Deed* does not represent the law in so far as it purports to lay down a general rule as regards fiduciary obligations.

[16] [1970] AC 567 (HL). Neither on the purpose trust/resulting trust analysis nor on P Millett's ("The Quistclose Trust—Who Can Enforce It?" (1985) 101 LQR 269) bare trust/mandate analysis is there any fiduciary obligation, for on both views the limits of the trust are essentially, ie, necessarily, determined by a contract of loan under which neither party stands as a fiduciary to the other.

and good faith where there is more than one beneficiary. Claims that the trustees have not acted with an even hand are not unusual. In *Nestle v National Westminster Bank*[17] one of the charges against the trustees was that they failed to act even-handedly. In the result the Court of Appeal did not consider the trustee to have breached this duty by tailoring its investments to benefit the current life tenants, because the court's appreciation of the duty gave the trustee a rather wide discretion,[18] but one can imagine another court taking a somewhat narrower view. The trustee did not, apparently, give much thought to its duty of even-handedness, as the investments favouring the life tenant seemed to have been made simply in response to the hectoring of one of the life tenants. If Paula's claims were made out, *Armitage* is clearly a fortiori to *Nestle*, since the allegation was that the trustees were loyal to the interests of her mother, *who was no longer a beneficiary at all*. Consider also *Re Pauling's Settlement*.[19] There the trustee bank acted solely at the instigation of one beneficiary of the settlement, the father. It was apparently the forcefulness of his personality which largely led it to ignore the children's interests and make the advancements it did. In neither *Nestle* or *Re Pauling's Settlement* did the professional trustees stand to gain significantly from the alleged breaches of trust; they did so in the absence of any "financial incentive" and it is not clear what "other incentive" they had beyond making their lives easier in the administration of the trust.[20] I take it that, leaving the issue of advertence aside, it matters not to the question of breach of fiduciary obligation whether the interests the trustees favour over the interests of the beneficiary are the trustees own interests or the interests of third parties. As Millett LJ says:

> It does not matter whether he stands or thinks he stands to gain personally from his actions. A trustee who acts with the intention of benefiting persons who are not the objects of the trust is not the less dishonest because he does not intend to benefit himself.

If it is no less dishonest to favour the interest of non-objects over objects, it is also no less a breach of fiduciary obligation to do so. So, although Millett LJ is right to suspect that any charge of actual fraud may be inherently implausible where the professional trustee gains no benefit by it, it is not clear why this suspicion should extend to an allegation of a breach of fiduciary obligation. However, one might respond to this point by saying that advertence is essential to treating a fiduciary as liable for serving, not his own interests in preference to the beneficiaries," but the interests of *third parties* in preference to the beneficiaries' interests. Look, for example, at the standard rules governing fiduciaries: the no profit rule, the no conflict rule, the self-dealing and fair-dealing rules, are all addressed to situations where the trustee's own interests might be favoured over those of the beneficiary, not cases where a third party's might be. Thus it might be argued that while inadvertent, even good faith, breaches of fiduciary

[17] [1994] 1 All ER 118 (CA).
[18] *Nestle* (n 17 above) 137 (Staughton LJ).
[19] [1963] Ch 576.
[20] See also *Wilson v Turner* (1883) 2 Ch D 521.

duty are actionable where the trustee's *own* interests conflict with the beneficiaries, only advertent cases of the trustee's favouring the interests of third parties ought to be actionable. At first glance, while this is plausible, it is clearly not correct. There is, for example, the clear rule governing the solicitor's fiduciary obligation to his client which applies when a solicitor acts for two clients in the same transaction. As Millett LJ puts it in *Bristol and West Building Society v Mothew*,[21]

> A fiduciary who acts for two principals with potentially conflicting interests without the informed consent of both is in breach of the obligation of undivided loyalty; he puts himself in a position where his duty to one principal may conflict with his duty to the other. . . . This is sometimes described as "the double employment rule." Breach of the rule automatically constitutes a breach of fiduciary duty.

Finally, it is not clear how else the duty of even-handedness can be accounted for save as a direct elaboration of the trustee's fiduciary obligation to serve his beneficiaries' best interests, meaning *all* of his beneficiaries' best interests. Clearly, cases where a trustee adopts a course of behaviour whereby he acts to favour the interests of third parties over the proper objects of the trust will be rare; human nature being what it is, the obvious danger is always that he will breach his fiduciary duty by favouring his own interest. But there would appear to be nothing in principle obviating the rule in the rarer case, and, on the facts alleged, *Armitage* stands as a clear example. If this is right, then if a clause such as clause 15 is not regarded as relieving a trustee of liability for breach of fiduciary obligation, its relief of liability for all other breaches of trust so long as they are not advertent does not extend to breaches of fiduciary obligation whether advertent or not. Thus it would appear to me that, framed as a breach of this kind, Paula might well have had a valid claim.[22]

## D THE IRREDUCIBLE CORE OF THE TRUST AND THE DUTY OF HONESTY AND GOOD FAITH

Millett LJ defends his determination of the limit of trustee exemption clauses by reference to the irreducible core of trustee duties, as the "minimum necessary

[21] [1998] Ch 1 (CA) 18–19, citations omitted.

[22] Cf. S Worthington "Fiduciaries: When is Self-Denial Obligatory" (1999) 58 Cambridge LJ 500; Worthington distinguishes between duties to act loyally and duties to pursue proper purposes in good faith; the former concern, roughly, cases where the fiduciary favours his own interests, the latter where the fiduciary acts improperly but does not obtain a profit or personal advantage. Worthington is principally concerned to argue that the remedy for the latter will align more with the typical remedy for breach of trust, ie, one which compensates the beneficiary's loss, rather than being one whose chief effect is to strip the fiduciary of a gain. If Paula's claim as described were to be successful, her claim would clearly be one of compensation to redress a loss, and so in this respect, in Worthington's terms, the breach shown by the trustees would not be a breach of fiduciary obligation, but one of pursuing improper purposes (favouring a non-object of the trust). However, to my mind this still manifests disloyalty to the beneficiary, even if inadvertent, and so therefore liability for this breach should not be relieved except by a clause relieving the trustee for breach of his fiduciary obligations (or, more likely, excluding fiduciary duties he might otherwise have).

to give substance to the trusts."[23] Millett LJ thus endorses a strong version of "freedom of trust," akin to a strong version of freedom of contract: so long as the legal arrangement of rights and duties voluntarily undertaken by the parties has some kind of workable legal effect, the law should give effect to it; it is not the role of the law to require parties to a legal arrangement to accept a standard "package" of terms, unless there is some sufficiently weighty countervailing public policy consideration. Distinguished from any strand linking it to the notion of fiduciary obligations *per se*, Millett LJ's essential core duty of loyalty and good faith reduces to the irremovable duty of the trustee not to commit a fraud on the beneficiaries, wherein fraud encompasses either intentional wrong-doing or reckless disregard of the beneficiaries' interests, thus dishonesty to some substantial degree. Thus the core duty of a trustee is determined according to a *standard of fault*, not a kind of duty. The essence of trusteeship accordingly concerns the *way* in which a trustee acquits or fails to acquit whatever duties the trust terms impose, dishonestly rather than negligently or innocently, not some minimum or essential *kinds of duty* which give the trust substance, such as the duty to keep the trust property separate from his own, or to keep the trust accounts, etc. With respect, it is submitted that this is misguided, and confuses the nature of duty with the nature of liability.

It is perfectly clear, as a matter of logic and principle, that with respect both to contracts and trusts, one could relieve a contracting party or a trustee of all personal *liability* for breach, and yet the contract or trust have "legal substance." The simple reason is that legal duties have more functions than serving as grounds for claims for breach of them. In the first place, consequences in the law arise whenever there is compliance with voluntarily-undertaken duties. For example, it is only by reference to contractual duties that have been complied with that certain rights, especially property rights, can be defended. Consider a contract of sale, whereby I transfer £1000 to you in consideration for your transferring me a piano, and assume we both comply with our duties perfectly. It matters that these transfers occurred under a contract, and not merely as mutual gifts. If for example, I wished to make a claim for restitution of the £1000 from you, saying that you were unjustly enriched by it, your obvious and effective response would be to point to the fact that you received it as consideration under our contract. More pointedly perhaps, consider the case where you were a trustee of that piano, and transferred it in breach of trust. I would only retain title to it as a bona fide purchaser *for value* given that I received it under our contract.[24] Secondly, in many cases breach functions to do more than merely

[23] *Armitage* (n 1 above) 253–54.

[24] The House of Lords' treatment of the gambling contracts in *Lipkin Gorman v Karpnale* [1992] 4 All ER 512 (HL) may appear to undermine this point, for was not the Playboy Club denied the defence of bona fide purchase because its contracts with the gambler were unenforceable, ie, one party would not be liable for breach? Well, perhaps. But it should be pointed out that their Lordships (at 519 and 522 (Lord Templeman), at 530 (Lord Goff)) interpreted the Gaming Act 1845 to the effect that payments to settle bets amount to voluntary gifts from the loser to the winner, or that in so far as wagers

serve as a ground for personal liability. For example, the breach of a contractual condition allows the other party to treat the contract as at an end.[25] Neither should any relief for the personal liability to compensate relieve a party from subjection to a court order of specific performance,[26] where appropriate.[27] In short, the "substance" of a contract subsists so long as there are contractual duties, and genuinely subsists in the absence of any liability on either party for breach. We are all familiar, of course, with the statement of Mr Justice Devlin (as he then was) in *Firestone Tyre & Rubber Co Ltd v Vokin's & Co Ltd*,[28]

> It is illusory to say: "We promise to do a thing, but we are not liable if we do not do it." If the matter rested there, there would be nothing in the contract.

But this seems to me to be a mistake, as is Coote's claim that the effect of a provision excluding liability is to exclude the duty in question.[29] Personal liability to make up for a breach of duty is conceptually a different thing from having that duty in the first place, and, as argued above, does not take into account the principal legal consequence of contracts, ie, the legal results they engender when they are performed according to their terms. To assume that the legal significance of contracts lies only in what courts may do when things go awry is to miss the forest for the occasional fallen tree.

are contracts they are not merely unenforceable, but void, at 520 (Lord Templeman), at 529 (Lord Goff)). It should also be pointed out that something particular may hang here on the fact that the contracts were not unenforceable by reason of an exclusion clause, but by statute, raising issues of public policy; secondly, and in any event, their Lordship's analysis is unconvincing, if not actually inconsistent with generally accepted authority on the nature of the effect of gambling contracts: on both these points see P Birks "The English recognition of unjust enrichment" [1992] LMCLQ 473, 493–96.

25 B Coote *Exception Clauses* (Sweet & Maxwell London 1964) 6, analyses this point by saying that the exoneration from liability for damages erases the contractual duty, and that the right to terminate the contract for breach of a condition is to be seen as the innocent party's right to take advantage of a condition precedent upon his own performance or payment, which if unfulfilled, releases him from his own obligations. But no true contract can be analysed in terms of mutual conditions in this way; see JE Penner, "Voluntary Obligations and the Scope of the Law of Contract" (1996) 2 Legal Theory 325, 333–335, and so Coote essentially begs the question: treating the right to terminate for breach in this way is to treat each party to the contract as having unlinked, though conditional, *unilateral* obligations, rather than linked obligations under a bilateral agreement. In short, he renders the contract as a pair of conditional gifts.

26 The fact that specific performance has traditionally been awarded as a kind of "further or better" relief where damages are inadequate should not blind us to the fact that the enforcement of a duty is conceptually distinct from making someone liable by substituting for the duty to perform a secondary duty of another kind, eg, to pay damages, which is what contractual liability for breach is, ie, a secondary obligation which is remedial.

27 Consider, for instance, that though in *Beswick v Beswick* [1968] AC 58 (HL) the defendant could not be liable to the successor in title of his promisee for more than nominal damages (the contract being one for the benefit of a third party), so that in effect he was not liable to compensate, this stood as no bar to an order of specific performance, and indeed was regarded as one ground for the court's making the award. As far as I know, no one argues that the difficulties of enforcing contracts for the benefit of third parties in terms of imposing liability to pay damages for breach *thereby* requires the conclusion that such contracts are not contracts in the law at all.

28 [1951] 1 Lloyd's List LR 32, 39.

29 Coote (n 25 above) 7 ff.

All this applies *a fortiori* to the case of a trust. Absolutely irrespective of the trustee's personal liability for breach, ie, his personal liability to account for his stewardship of the trust property, the existence of the trust obligation has profound legal consequences. To take but one, it is only because there is a trust that the trustee's legal ownership of the trust property is not a ground for his trustee in bankruptcy's disposing of it for the benefit of his creditors. Furthermore, dealings with trust property in compliance with the terms of the trust are the justification in law for those transactions being valid for the parties involved. A volunteer recipient acquires a beneficial legal title to the trust property he receives only in so far as the transfer was made according to the trust terms, ie, only in so far as he is a proper object of the trust—otherwise he is a volunteer recipient of trust property which is bound by the trust for the true beneficiaries. The case for the effectiveness of trust duties even in the absence of liability is all the more clear where a breach of trust has occurred. Regardless of any personal liability of the trustee to make up the trust account from his own pocket, any transaction in breach of trust that can be falsified on the trust account can be reversed so far as the rules of following and tracing and the rules governing the personal liability of strangers to the trust can be applied. Furthermore, a trustee's breaching the trust is a general ground for the replacement of the trustee, and may be a ground for a claim for unjust enrichment for restitution of his trustee charges, if any. All of these effects occur even where the trustee is not personally liable even for fraudulent breach of trust.

If we switch our focus from the trustee's personal liability to his essential duties, what might those essential duties be? The essence of the trust from the trustee's perspective is that the property is not (wholly[30]) his own, and cannot be put into a situation where it might be available to his creditors, or would otherwise be treated as part of his estate, either on death or bankruptcy. From this it follows that the core trustee duties are (1) the duty to keep the trust property separate from his own and keep the trust accounts, and (2) to comply with the trust terms if any; in short, to be a trustee, the legal owner of property must have a duty to deal with the property in such a way that those with claims against the trust[31] can (1) identify the current subject matter of the trust so as to be able to invoke the rules about following and tracing into the hands of those not entitled to it (which may, of course, include the trustee) plus any rules governing the personal liability of third parties for assisting in such a transaction or receiving trust property or its traceable proceeds via such a transaction, for otherwise the trust property is not truly bound by the trust; and (2) to determine who is actually entitled to the benefit of the trust property, so as to know when the rules about following and tracing and the personal liability of third parties are properly to be invoked.

[30] He may be one of several beneficiaries.

[31] I refrain from referring to those with claims against the trust as beneficiaries, for reasons which will become apparent below.

To put this another way, the claim is that so long as those with claims against the trust are truly able to falsify the trust account, the personal liability of the trustee is not essential to give substance to the trusts; to paraphrase Millett LJ, the ability to falsify the trust account is the minimum necessary to give substance to the trust, but in my opinion it is sufficient. It follows from this that the ability to surcharge the account, ie, "to make the trustee account, not only for what he has in fact received, but also for what he might with diligence have received,"[32] is not an essential feature of the trust, for that personal liability attaches to a trustee's duty to invest the trust property, and not all trusts impose such a duty.

Where have we got? It seems that by the ineluctable logic of seeking to determine the minimum extent of trustee duties and liability on the basis that we look to the "minimum" necessary to give substance to the trust, there need be no personal liability upon the trustee *at all*. He may be exempted from any personal liability whatsoever. It seems to me that this is right, and if it gives us pause, we should ask why? What sort of intuition might lead us to think that somehow, somewhere, in this logic, we have gone astray? I would now like to try to explain that this result only flows from conceiving of the trust in a particular way, and that by conceiving it otherwise we get a much different result.

## E THE "OBLIGATIONAL" TRUST: THE MULTI-PATRIMONIAL VIEW OF THE TRUST

Trusts are trusts of property, so any conception of the trust must at a minimum engage rules of property. On the view of the minimum substance of the trust I have just rehearsed, the essence of the trust is that the trust property does not form part of the trustee's proper personal estate, hence the core duties of the trust are those that give effect to the idea that the trust property is not the trustee's own. But this view takes a particular perspective on the "proprietary" aspect of the trust, which brings it very much in line with the "multi-patrimonial" view of the trust, which may be seen to be arising from a concern to bring a workable trust concept to civilian jurisdictions.

What the Hague convention rules require,[33] and what appears to be the minimum required by the "principles of European Trust Law,"[34] is that for a property holding to be a trust, the trustee must hold the property separate from his personal patrimony in order to give effect to the claims of others on the

[32] P Millett "Equity's Place in the Law of Commerce" (1998) 114 LQR 214, 226.

[33] The Hague Convention on the Law Applicable to Trusts and on their Recognition, implemented by the Recognition of Trusts Act 1987, Art 2, 11.

[34] D Hayton S Kortmann and H Verhagen Principles of European Trust Law (Kluwer Law International The Hague 1999) esp 13–20. See also D Hayton "The Developing European Dimension of Trust Law" (1999) 10 King's College LJ 48 and my review of the book, JE Penner (1999) 13 Trust L Intl 199, and S Dix (tr) M Lupoi Trusts: A Comparative Study (Cambridge University Press Cambridge 2000) 2–3.

property, whether "beneficiary"-like claims for the personal benefit of individuals, or claims to enforce trust purposes. But very importantly, in keeping with the civilian concept of the unity of ownership, it is not stated, nor is it required, that there are any individuals (other than the trustee of course) who have "ownership" of the trust property. There need be no beneficial owners "in equity"; indeed, I think the presumption is that there are not. The general idea is rather that the trustee has two patrimonies. His first, the one we all have by virtue of being a subject of the law, might be called[35] his *general* patrimony. It's the one we're all generally born with, and into it by default go all our rights to any assets of whatever kind, and it is the one which is liable to satisfy any general claims against us. But the law may provide the facility to acquire a second (or third or fourth or *n*th) patrimony (it does not matter however many more one acquires), in respect of which only particular special rights and duties attach. These subsequent, special patrimonies, are what "European" trusts amount to. That they are separate patrimonies ensures that proprietary consequences flow from their acquisition; the property within them does not form part of the trustee's general patrimony, and so is not, in English terms, available to form part of his estate on death or bankruptcy, and is not available to satisfy the claims of his general creditors or be available to him to make gifts to others. It is quite clear, then, that the multi-patrimony view of the trust has a distinct and strong proprietary aspect.

Even so, I have termed the "multi-patrimonial" trust just described as an "obligational" trust, because the substance of the trust is determined by the extent of a trustee's obligations in respect of particular property. To the extent those obligations exist, the property is not the trustee's own in the sense that it is not part of his general patrimony. But notice: there is no requirement that the property belongs *to someone else*. The particular obligations the trustee is held to be under are not conceived to flow as *specifications* of the fact that he is in control of someone else's property, and therefore must hold this property for their benefit. Rather, we start from the position that the property is the trustee's own, but subject to special obligations which have proprietary effect in binding this particular subset of what, in total, he owns. The character of the trust is "obligational" rather than "proprietary" in the sense that the "proprietary aspects" are instituted to help ensure that the obligations of the trustee are met. It is not "proprietary" in the sense of the traditional trust, which begins from the proposition that someone else is the owner of the property to which the trustee has legal title, irrespective of any particular obligations the trustee may have in respect of the property. The basic obligation of the trustee from this perspective is to recognise the beneficial owner's entitlement to the property, which means not merely that he doesn't treat it as his own, but that he treats it as that person's.

[35] Following Hart's distinction between general and special rights: HLA Hart "Are there any natural rights?" in J Waldron (ed) Theories of Rights (OUP Oxford 1984) 77, 83–88.

Perhaps this appears to be a very fine distinction, with little real world consequence. But in fact, only by regarding the trust as proprietary rather than obligational/multipatrimonial, can one make sense of much traditional trust doctrine, in particular the principle in *Saunders v Vautier*[36], the former requirements of certainty of objects, the operation of automatic resulting trusts, the beneficiary principle, following trust property, and the liability of the trustee under contracts made for the benefit of the trust. I shall look at each of these briefly to make the point. However, the traditional force of these rules has increasingly been subject to criticism and inroads of various kinds. Hence I shall also argue that the trajectory of modern trust doctrine is to move closer to the multi-patrimonial view of the trust, a trajectory most recently laid out and commended by Professor Hayton.[37]

The principle in *Saunders v Vautier* is that the property being the beneficiary's, not the trustee's, and not the settlor's[38], the *sui juris* beneficiary is entitled to treat the property as his own, and therefore may exercise the normal powers of ownership, in particular to dispose of his property as he wishes. To the extent that the property is indefeasibly vested in him in equity, and there are no conditions or other difficulties with his calling for the trust property, he can demand the legal transfer of the trust property or his aliquot share.[39] This power cannot derive from the obligations of the trustee under the trust or the trustee's legal ownership of the trust property, for by its exercise it specifically defeats those obligations and that ownership. The power can only be justified as one of the powers of ownership, which comes part and parcel with the beneficial ownership in equity. No similar rights can be spelled out of the multipatrimonial obligational trust. However, while some inroads have been made against this principle in England,[40] in other jurisdictions the principle has been

[36] (1841) 4 Beav 115; affd (1841) Cr & Ph 240.

[37] D Hayton "Developing the Obligation Characteristic of the Trust" (2001) 117 LQR 96. See also A Duckworth "Trust Law in the New Millenium" (in three parts) [Nov 2000] Trusts and Trustees 12, [Dec 2000/Jan 2001] Trusts and Trustees 11, [Feb 2001] Trusts and Trustees 9.

[38] Thus Waters rightly says:

. . . the trust is a mode of disposition, and once the instrument of creation of the trust has taken effect or a verbal declaration has been made of immediate disposition on trust, the settlor has alienated the property as much as if he had given it to the beneficiaries by an out-and-out gift. This almost self-evident proposition has to be reiterated because it is sometimes said that the trust is a mode of "restricted transfer." So indeed it is, but the restriction does not mean that by employing the trust the settlor inherently retains a right to revoke or a power to intervene once the trust has taken effect, whether to set the trust aside, change the beneficiaries, name other beneficiaries, take back part of the trust property, or do anything else to amend or change the trust. By restriction is meant that he has transferred the property but subject to restrictions upon who is to enjoy and to what degree. The mode of future enjoyment is regulated in the act of transferring, but the transfer remains a true transfer. DWM Waters The Law of Trusts in Canada (2nd edn Carswell Toronto 1984) 291.

[39] *Stephenson v Barclays Bank Trust Co. Ltd* [1975] 1 All ER 625; *Lloyds Bank v Duker* [1987] 1 WLR 1324; *Re Smith* [1928] Ch 915.

[40] In particular *Re Brockbank* [1948] Ch 206, in which Vaisey J held that *sui juris* beneficiaries were not entitled to demand that a trustee retire in favour of another, now reversed in part by the Trusts of Land and Appointment of Trustees Act 1996 Part II. However, cases such as *McPhail v Doulton* [1971] AC 424 (HL), discussed below, also appear to limit the force of the principle.

clearly weakened, in particular by attaching some kind of limitation of the beneficiaries' rights by reference to the purpose of the settlor such that any proposed calling for the trust property or variation consented to by all beneficiaries is prohibited to the extent that it would detract from a "material purpose" of the settlor in creating the trust.[41] English law flirted with such a limitation in the context of the court's providing its consent for contingent beneficiaries under the Variation of Trusts Act 1958,[42] but happily this deviation has recently been scotched.[43]

Traditionally, the test for certainty of objects required that all the beneficiaries were ascertainable, such that a trustee could draw up a complete list of them.[44] The essence of this requirement is that to the extent that the trustee cannot ascertain all the beneficiaries, he cannot be administering a trust for all of those beneficiaries. Clearly, so long as *some* beneficiaries are clearly identifiable there is no problem of enforcing the trust against the trustee so as to ensure that the trustee is not able to treat the property as his own, which seems to underlie the relaxation of this requirement in *McPhail v Doulton*.[45] But it does not seem possible to treat an unascertainable class as genuine beneficial co-*owners* in equity, for it would seem axiomatic that for the existence of a property right to exist, the identification of the owner or owners cannot be "in the air"; there could clearly be no such indefinite ownership at law. And there is, of course, no possibility of such a class exercising any *Saunders v Vautier* powers. Thus *McPhail* stands as an example of the trend toward the obligational trust and away from the proprietary trust.

It would also appear that only on the proprietary view of the trust can the normal operation of automatic resulting trusts be explained though, again, this proprietary underpinning may now be being undermined. The traditional understanding is that, where a settlor has failed to dispose of the entire beneficial interest of property transferred on trust, the remainder remains his in equity. It is straightforwardly a question of whether he has managed to transfer an interest in property to another. As Plowman J said in *Vandervell v IRC*[46]: "As I see it, a man does not cease to own property simply by saying 'I don't want it'. If he tries to give it away the question must always be, has he succeeded in doing so or not?" The statement was approved by Lord Upjohn[47] and most recently by

[41] See, eg, American Law Institute *Restatement of Trusts 2d* (American Law Institute St Paul Minn 1959) ss 337–339; Bahamas Trustee Act 1998 s 87. There may be supposed to be a related limitation in English law concerning whether a variation of trust under the Variation of Trusts Act 1958 must preserve "the substratum" of the original (see *Re T's Settlement Trusts* [1964] Ch 158; *Re Ball's Settlement* [1968] 2 All ER 438, but the reasoning lying behind this supposed limitation is unsupportable: see JE Penner *Law of Trusts* (2nd edn Butterworths London 2000) 306–07.

[42] In *Re Steed's Will Trusts* [1960] Ch 407.

[43] *Goulding v James* [1997] 2 All ER 239 (CA).

[44] *IRC v Broadway Cottages Trust* [1955] Ch 20 (CA).

[45] [1971] AC 424 (HL).

[46] *Vandervell v IRC* [1966] Ch 261, 275.

[47] *Vandervell v IRC* [1967] 2 AC 291 (HL) 314.

Lord Millett in *Air Jamaica Ltd. v Charlton*[48]. But this analysis has been doubted; in *Westdeutsche Landesbank v Islington LBC*[49], (in the course of an opinion in which he emphasised the obligational aspect of the trust so far as to deny that a legal owner of property that was someone else's in equity, but who was not subject to particular trust obligations so that his conscience was effected, ought properly to be called a trustee[50]), Lord Browne-Wilkinson considered the idea that the automatic resulting trust operated as a matter of the legal requirements of property transfer, rather than as a matter of the settlor's intentions, and was:

> not convinced that this is right. If the settlor has expressly, or by necessary implication, abandoned any beneficial interest in the trust property, there is in my view no resulting trust: the undisposed-of equitable interest vests in the Crown as bona vacantia.[51]

If this is right, then by virtue of disposing of property on trust with the requisite intention, a person can do what he can't do at law, ie, by his own act simply make his property ownerless. But on the multi-patrimonial view, this is the essence of the transaction.[52]

From the multi-patrimonial view of the trust, the problem with purpose trusts is that by simply naming a purpose, there is no one to enforce the trust against the trustee. And the remedy for this is obvious: so long as one can generate some kind of enforcement mechanism, whether providing standing to the Attorney-General or the Charity Commissioners for public purpose trusts, or by the creation of the position of "enforcer" of the trust, then the problem has been surmounted.[53] However, more than the problem of enforcement must underlie the traditional stance of English equity that private purpose trusts are invalid, for equity has itself derived an enforcement mechanism for those anomalous private purpose trusts which is does hold valid, ie, the *Pettingall* order.[54] Such an order could be constructed to give effect to any purpose trust,[55] and so

48 [1999] 1 WLR 1399 (PC) 1412.

49 [1996] AC 669 (HL).

50 *Westdeutsche Landesbank* (n 49 above) 707.

51 *Westdeutsche Landesbank* (n 49 above) 708, citing *Re West Sussex Constabulary's Widows, Children and Benevolent (1930) Fund Trusts* [1971] Ch 1.

52 There are other problems with this approach. In particular, an intention to abandon is not an intention to make a gift to the crown, and in *inter vivos* cases such as *Re West Sussex* (n 51 above), it is not clear why the abandoned property should be treated as *bona vacantia* rather than property available to anyone to be appropriated; why should not the property on this view simply become the trustee's?

53 "Offshore" jurisdictions have in particular produced legislation to permit purpose trusts enforced by enforcers, the most (in)famous example of which is the Cayman Islands' STAR trust, provided in the Special Trusts (Alternative Regime) Law 1997. See P Matthews "Shooting Star: The New Special Trusts Regime from the Cayman Islands" (1997) 11 Trust L Intl 67; A Duckworth "STAR WARS: The Colony Strikes Back" (1998) 12 Trust L Intl 16; P Matthews "STAR: Big Bang or Red Dwarf" (1998) 12 Trust L Intl 98; A Duckworth "STAR WARS: Smiting the Bull" (1999) 13 Trust L Intl 158.

54 From the order made in *Pettingall v Pettingall* (1842) 11 LJ Ch 176; see Penner (n 41 above) 255–56.

55 *That* the court could, rather than *whether* the court should, devise such an order appears to be the basis for validating the trust in *Re Thompson* [1934] Ch 342, which of course puts the cart before the horse and renders the decision more than suspect; see Penner (n 41 above) 256.

something else must underlie the traditional position. It is submitted that this is simply that in this area of doctrine the proprietary conception of the trust continues to hold sway if only implicitly[56], so that English equity is not ready yet to countenance such obvious cases of beneficially ownerless property.

As to following[57] trust property, it would now seem conventional, I think, to say that a beneficiary's claim that trust property in the hands of a third party to which it has been transferred in breach of trust is a claim to a continuing equitable title in that property and that, where the transfer is to a *bona fide* purchaser, the transaction is one which defeats the beneficiary's equitable title. This way of explaining this law only works on the basis that the beneficiary is regarded as the equitable owner or owner "in equity" of the trust property. It is not merely the case that he has rights against a particular portion of the trustee's own property, ie, claims against a second patrimony. (It is worthwhile pointing out that under the Hague Trusts Convention[58] the right to follow trust property is not regarded as an essential feature of the trust; the existence of such a right is a matter to be determined by the "proper law" of any particular trust.) Of course, there are alternative tellings of the beneficiary's right to follow trust property which make no reference to his continuing equitable title. It can be regarded as a case of a proprietary right against the recipient arising by operation of law to prevent the recipient's unjust enrichment; I have a hunch this view is becoming popular. Or one can treat the trust as a kind of contract in which the "beneficiary" acquires a claim which is a secured interest of some kind or another in the specified property.[59]

Finally, consider the notion of "creditors of the trust". The traditional position is well stated by Hayton[60]:

> A trust, unlike a company, has no legal personality: thus it cannot own property or enter into contracts, sue or be sued. It is the trustees who own the trust property, enter into contracts, sue or are sued. A trustee as such has no distinct legal personality in his representative capacity separate from himself in his personal capacity. Thus, he is personally liable to the extent of his whole personal fortune for debts contracted in managing the trust fund, whether contracting in his own name or as trustee, unless he makes it clear that he is to be liable only to the extent that the trust fund is available to him to satisfy the liability. To discharge liabilities properly incurred by him as trustee he has a

[56] Thus in cases like *Re Lipinski's Will Trusts* [1976] Ch 235 where the court focuses clearly on the beneficial ownership of the property, any valid "purpose" like the one found in *Re Denley's Trust Deed* [1969] 1 Ch 373 has been read down so as to be essentially non-binding; see Penner (n 41 above) 252.

[57] Understanding tracing from these different perspectives is more, perhaps much more, complicated.

[58] Hague Trusts Convention (n 33 above) Art 11(d).

[59] J Langbein "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale LJ 625, 647–48. Consider, however, that this kind of abstract security interest is the creation of equity; it is not clear how much sense can be made of it without the idea of the (more or less limited) beneficial ownership characterised by the proprietary view of the trust.

[60] D Hayton *Hayton and Marshall's Commentary and Cases on the Law of Trusts and Equitable Remedies* (10th edn Sweet & Maxwell London 1996) 5–6.

right of indemnity against the trust fund (subject to any countervailing equities of the beneficiaries for breach of trust) and creditors may be subrogated to this right.

The position, then, under the traditional trust is not that the trust beneficiaries are like a particular set of creditors who can claim against a particular patrimony only, and correspondingly, the trustee is differently liable to different sets of creditors from different patrimonies. Rather, the trustee is equally personally liable to all who may make a claim against him, beneficiaries, general creditors, spouses, the lot—the reason why the trust fund is not available to him to satisfy any and all claims is not because he is separately a debtor to the beneficiaries *qua* creditors and the "trust" is the particular separate pool of assets segregated for that purpose, but because the property belongs, beneficially, not to him but to someone else. The trustee does not hold separate but equal patrimonies for separate but equal sets of creditors/beneficiaries, but has only one personal patrimony against which the beneficiaries are fully entitled to claim should they make a claim against him, for compensation for breach of trust for example. The separate "trust" patrimony, is in substance not his patrimony at all, but someone else's, and that is why his personal creditors have no claim upon it. But reform is in the air. The Trust Law Committee, following a consultation with the profession, has recently produced a report[61] proposing a legislative reform the essence of which is that the trust fund will be "primarily liable" for any claims in tort or contract resulting from the trustee's administration of the trust, whether within the terms of the trust or not so long as the trustee was not actually dishonest. Thus the trust fund can therefore become "insolvent," ie, a special patrimony of the trustee can be more than extinguished by the claims of the special creditors to it. If this reform is adopted, the multi-patrimonial concept of the trust will for all intents and purposes be enshrined in English law, and quite clearly, the traditional "proprietary" concept of the trust would essentially be ousted. There is no better evidence of the trend towards the "obligational" and away from the "proprietary" conception of the trust than that a committee of English trust lawyers has proposed a change requiring such a fundamental reorientation of the trust concept in this direction.

## F EXEMPTION CLAUSES REVISITED

If I have correctly described the way the law is going, then the trust will more and more be regarded as primarily obligational, as a constellation of rights and duties attaching to a special patrimony. In so far as the trust is primarily a matter of obligations, there seems no reason why "freedom of contract" or "freedom of trust" should not reign, just as Millett LJ seems to think. And as I have also tried to show, there is no intellectually coherent stopping point at

[61] Trust Law Committee *Report: Rights of Creditors Against Trustees and Trust Funds* (Butterworths London 1999).

which trustees cannot be relieved of liability, so long as the core trustee duties are in place which secure the segregation of the trust patrimony from the trustee's other patrimony(ies). As long as the account can be falsified, the segregated trust patrimony has legal substance. Any limitations on the liability of the trustees must be policy-based, not conceptual.

Are there any policy-based reasons to deny settlors and trustees complete freedom of latitude in relieving trustees of personal liability for breach of trust? One can imagine circumstances where it might be perfectly sensible to extend relief from personal liability for all breaches up to and including dishonest breaches, say, to a family member who serves as trustee of a family trust—bear in mind that the account can always be falsified, and even bad faith transactions reversed so far as the rules of following, tracing, and the personal liability of accessories and third party recipients may do so. It does not appear to me that there is any obvious reason of public policy why the law should disallow such arrangements. Nevertheless, it is clear that this is not a typical case of trust, and perhaps our focus should lie only upon *professional* trustees. As Millett LJ stated in *Armitage*[62]:

> [I]t must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence, should not be able to able to rely on a trustee exemption clause excluding liability for gross negligence. . . . The subject is presently under consideration in this country by the Trust Law Committee under the chairmanship of Sir John Vinelott. If clauses such as clause 15 of the settlement are to be denied effect, then in my opinion this should be done by Parliament which will have the advantage of wide consultation with interested bodies and the advice of the Trust Law Committee.

The Trust Law Committee has spoken; in its Consultation Paper on Trustee Exemption Clauses[63] it states a general preference for a statutory provision whereby trustees remunerated for their services would not be entitled to be relieved of liability for negligent breach of trust. In view of the availability of insurance cover and general efficiency considerations such as the value of having a relatively rigid rule, this seems perfectly sensible. However, I want to conclude by suggesting that a similar rule applying to all trustees might logically follow not from policy considerations, but from the very nature of the trust, if a "proprietary" perspective is taken.

Let us begin from first principles: the trust device is a unique (if not strange) combination of obligations and property rights. A trust therefore necessarily has both obligational and proprietary aspects. I have already characterised the obligational, multipatrimonial view, in which the obligational aspect is emphasised, and the proprietary aspect diminished to the bare minimum. Now it is

[62] *Armitage* (n 1 above) 256.

[63] Trust Law Committee *Consultation Paper on Trustee Exemption Clauses* (Butterworths London 1999).

time to consider this device from a robust proprietary perspective. According to this view, the trust is a structured transfer of property from the settlor to the beneficiaries. The trust allows the settlor to structure the benefit of his transfer in ways unavailable at law. It can achieve this because the legal title holder can be treated as an office-holder with obligations to give effect to the structure imposed upon the property, thus giving effect to the structure of the gift. The trust does not depend upon the identity of the trustee—a trust will not fail for the want of a trustee, and any individual may retire from the office of the trustee. Therefore the trust cannot be treated as a contract for the benefit of a third party, for contracts arise between individuals as such, and so it is wrong to think of the settlor "contracting" with an individual to hold the legal title of the property for the benefit of the other, as if this imposed a personal obligation upon that person. The trust then, is a property device which incorporates a dispositional structure which requires the engagement of a person, for it needs a person to operate it, but it matters not who that person is. The law will see to it that someone will operate that structure, the court itself if necessary.

Now, if we take seriously the proprietary nature of the trust, we understand that the trust property beneficially (1) belongs to the beneficiaries, each to the extent of their beneficial entitlement under the structure of the transfer, and correlatively, (2) belongs to no one else, including the trustee. (Assume for the moment for simplicity's sake that any trustee for the time being has no beneficial interest, ie, is not also a beneficiary; the point will apply *mutatis mutandis* to the case where the trustee is a beneficiary, but this assumption *pro tem* facilitates the exposition). As regards any trespass against or interference with the property so as to defeat the interests of the beneficiaries under this dispositional structure, the trustee is as much a third party as is anyone else, and of course all subjects of the law have a duty not to interfere with the property of others. What differentiates the trustee for the time being from all other non-beneficiaries, and what *alone* differentiates the trustee, is that having taken legal title to the trust property he acquires the powers of legal ownership, and is subject to the trust obligation to employ those powers to give effect to the dispositional structure of the trust. Therefore, to the extent that a trustee deals with the trust property in such a way as to defeat this dispositional structure (to the extent that he carries out a transaction that can be falsified on the account) then just as much as any other non-owner of the property he is interfering with the beneficiaries' property rights. With respect to trustee exemption clauses, then, the question we must ask is whether an owner can transfer property, eg, whether a donor can make a gift, in a way which would relieve non-recipients of that transfer of personal liability for interference with the recipient's beneficial title.

I suppose, theoretically, one might at common law have granted land upon condition subsequent that the gift would determine if the donee sought to make a particular trespasser or class of trespassers or all trespassers personally liable, though I imagine (I know of no such case) that a court might have regarded such a condition, especially in favour of all trespassers, as repugnant to the character

of a gift. But I raise this possibility only to show that it is beside the point and so avert a misconception: the question is not whether such a condition could be imposed upon a donee, for such a condition is not equivalent to the trustee exemption clause. A trustee exemption clause does not limit the donee/beneficiary's rights, as a bar against the beneficiary's right to bring an action against the trustee, but operates to relieve the trustee of liability if such an action is prosecuted. An exemption of this kind is one which is given to the one relieved of liability; it is not an imposition upon the donee. Once this is made clear, it is obvious that any act of the donor purporting to have this effect is a nonsense. I cannot unilaterally provide a personal benefit of this kind even over my own property. I can, of course, forbear from suing any trespasser, but only by actually entering into a binding agreement or by making a binding promise by covenant can I actually grant someone an exemption from liability. A relief from liability is a personal right, and thus can only be granted *in personam*. I cannot grant personal rights to all at will, and certainly not by somehow attaching such rights to my property; there is simply no power in law that attaches to my title to property to do this. And, of course, I cannot do for my successor in title, my donee, that which I cannot do myself as owner.

Therefore, because the trust terms are not a matter of agreement between a settlor and any particular individual, but are rather terms which "run" with the property binding successors in title, and because relief from liability can only be given to particular individuals qua individuals, a trustee exemption clause cannot operate to relieve a trustee of liability. Trustee exemption clauses are not exactly repugnant to the trust; they are ineffective because they purport to do that which is simply conceptually impossible.

Now it may be responded to this conclusion that it incorporates a misconception. True, a trustee exemption clause attaches to the trust, and therefore cannot be conceived as granted to any particular individual, still, any trustee for the time being takes up the trust voluntarily, and to this extent the incoming trustee does what is equivalent to taking up one side of an agreement, and therefore can take advantage of any advantages of that agreement, such as an exemption clause. It is simply not to the point, this argument goes, that the contract or agreement is not one which is made personally with any particular person. By voluntarily taking up the trust, the trustee partakes sufficiently in an *in personam* bargain-like arrangement that it is perfectly acceptable for him to take advantage of a limitation of liability that partly frames that bargain. Following this reasoning, the trustee is in a crucially different position from *any* unspecified non-owner of the trust property, even when he acts contrary to the terms of the trust, for even then he acts *as a trustee*. Therefore, as trustee he can take advantage of any aspect of the voluntary agreement that benefits him, thus can take advantage of a term relieving him of liability for breach.

The difficulty with this response, however, is that it requires we regard the trust from the obligational perspective, and not the proprietary perspective, the very perspective I am trying to elaborate. From the obligational perspective, all

the terms of a trust are agreed between settlor and trustee so as to create a kind of voluntary agreement to deal with property for the benefit of third parties, and so if the agreement includes provisions relieving the trustee of liability, so be it. As I have said already, this is perfectly correct on this perspective, and indeed I would go further than Millett LJ and allow the relief of a trustee for personal liability even for fraudulent breaches. But from the proprietary perspective, the trustee is not like a "contracting party", but is rather the *grantee* of a property which is burdened in a particular way, and so the incidents of the property he is granted must be incidents which can run with the property, and personal rights like the benefit of an exclusion clause cannot.

Now, you may respond: but the settlor by drawing up a particular trust subjects his trustees for the time being to all kinds of obligations, *personal* obligations, to invest and so forth—these clearly do not bind all third parties; only the person undertaking the trust is personally bound by them; if that is so, why cannot the settlor also provide personal exemptions for the persons who, for the time being, undertake the trust? The mistake here, from the proprietary perspective, is to regard the obligations of trusteeship as being imposed by the settlor personally upon the trustees. They are not. They are imposed by operation of law upon a person when he takes title to trust property. By taking title to trust property, a trustee does not undertake any personal commitments to a settlor; he undertakes personal commitments to the beneficiaries, whom he need never personally have met, much less come to any agreements with by which they might have conferred personal rights upon him. His personal obligations to the beneficiaries flow entirely from the fact that he takes title to property which is beneficially theirs. All of the obligations of the trust, from keeping the property separate and keeping the trust accounts and disposing of the property according to the trust terms and the general fiduciary obligation are all obligations imposed by the law, ie, are default terms, which over the history of the trust the law has found important to impose, but impose purely as a function of giving effect to the fact that the property belongs beneficially not to the trustee, but to the beneficiaries.[64] It is worthwhile remembering that we should not be fixated only upon duties here; the settlor doesn't provide the trustee with any *powers* either. They arise by virtue of his legal title to the trust property. As legal owner he has the power to engage in any transaction with the property which the law allows to any owner. It is by virtue of the law's imposing duties upon the trustee that these powers are used for the benefit of the beneficiaries, rather than for himself. The settlor's freedom of trust, then, on the proprietary view, is not to impose obligations upon the trustee, but (1) to divide up the beneficial interest in the trust property in whatever creative, conditonal, contingent, ways that he wishes, so long as he complies with general rules governing dispositional freedom such as the rule against perpetuities or rules limiting accumulations, and (2) to limit or cut down the duties that the law would otherwise impose on the

[64] With one exception, the duty to invest, which will be discussed shortly.

trustee, right down to a bare trust if he so wishes. In short, the obligations of the trustee are not ones which are decided by agreement between the settlor and himself, but arise by operation of law to give effect to the essential element of the trust, which is that the legal owner holds the legal title for the benefit of someone else. True it is that the trustee voluntarily undertakes the trust, but voluntarily only in the sense that anyone can refuse a transfer of property, or disclaim an interest in property given under a will. If he takes it, he is bound by its chief incident, which is that the benefit of it belongs to someone else. And if he does receive a benefit from it, say by way of a trustee remuneration clause, he receives that as a kind of beneficiary, not as contractual consideration.[65]

If this is right, then there is no parity of reasoning with the case of contract, whereby as a bargain the settlor and trustee can shape duties and limit liabilities as they wish. From this perspective, the settlor's only power along this line would be to give a particular person who intended to take up the role of trustee a personal indemnity against any liability he might incur in his transactions with the trust property. The law, or the beneficiaries themselves, of course, could also relieve any particular trustee for the time being of liability for any breach of trust.[66] But any general trustee exemption clauses would, as stated above, be ineffective.

But surely, surely, the reader may reply, the flexibility of the concept of property, particularly in its equitable manifestation, must provide for something like the trustee exemption clause. The reader is right to think so, and I shall get to it in one moment, with the proviso that the reader may not like what he hears. But first, a wrinkle in the preceding analysis must be attended to, to wit: if we conceive of the "duty to invest" the trust property as being no more than the duty to "preserve" the trust assets, then I would stand by the general proposition that no clause could relieve a trustee of personal liability for failing to do so, for that would appear to be only the duty not to defeat the beneficiaries' beneficial entitlement to the property by acting carelessly or worse in respect of it. However, to the extent that the duty to invest is imposed so as to require a trustee to achieve a level of return determined by reference to that which could be achieved by a sophisticated professional investor, I think the obligational perspective must prevail with respect to this particular duty. The point is a simple one—to the extent that a duty is imposed by operation of law upon any grantee of property, it must in general be one with which any grantee could comply. To the extent that the actual personal characteristics of the grantee matter for the incident of property to operate, it would seem to be impossible to regard it as an incident that could properly run with the property, or at least, it would seem unjustified that it should. It is arguable that the standard of investment now required by law may be of this higher kind,[67] and could only be justified on the

[65] *Re Duke of Norfolk's Settlement Trusts* [1982] Ch 61. Trustee Act 2000 Pt V now also provides for the remuneration of trustees.

[66] Eg, Trustee Act 1925 s 61.

[67] Eg, Trustee Act 2000 Pt II.

obligational perspective. If so, then it would follow that the settlor ought to be allowed to relieve a trustee for liability for breach of this duty. As I said previously, it does not seem to me necessary as a core feature of the trust that the beneficiary be able to surcharge the account. It is important to emphasise that this apparent concession to the obligational perspective is not a concession really. The point of raising the proprietary perspective was not to deny that there may be elements of modern trust law which cannot but be explained by treating the trust as something very much like a kind of contract under which the trustee undertakes personal obligations. The point of raising the proprietary perspective is to vindicate one source of our understanding about the nature of the trust, a source of understanding which at the present time may be being eroded. From the outset it was submitted that the trust can only be regarded as a combination of proprietary and obligational elements. The question is how we strike a balance between our concepts and ideas about these elements, in perhaps the fond but forlorn hope that a coherent balance can be struck, so as to produce a principled trust law. The point, of this paper at least, is not to argue for a thorough-going "theory" of trust law based on some abstract concept of "proprietary right," which accounts for all the settled law. Rather, the aim has been to identify a sometimes hidden but essential basis for our making as much sense as we presently do of trust doctrine.

With this in mind, we can return to a "proprietary" version of the trustee exemption clause. One particularly salient reason for thinking carefully about how this sort of device works is that our response to it may reveal much of our intuitive reservations or disquiet with broadly-drawn trustee exemption clauses of the kind expressed by Lord Millett in *Armitage* and by the Trust Law Committee, reservations which are hard to capture or justify from the obligational perspective.

Consider a grant to a life tenant "without impeachment of waste," which provision runs with the estate to a third party grantee (of an estate pur autre vie). Is that not a relief from liability which runs with the land, with the estate? Not really. To grant without impeachment of waste is essentially to grant a larger interest in land than is the default position at law; it is to provide the life tenant with ownership rights having the scope of those of a fee simple owner, to do, as it were, what he will, such that the reversion need be in no particular shape when it falls into possession. He is by this larger grant relieved of a kind of stewardship of the property for the reversioner, and accordingly such a grant of a larger than normal interest provides a model for the "proprietary exemption clause." The settlor can grant the trustee (and, of course, the trustee's successors in title as trustees) a contingent interest in the trust property capable of defeating *pro rata* the interests of the other beneficiaries to the amount that the trustee is personally liable for a breach of trust. The proprietary exemption clause is thus a contingent interest in the trust property itself, rendering the primarily intended beneficiaries' interests defeasible *pro rata* upon the trustee's acquiring a personal liability to restore the trust. The trustee is not relieved of

any duty to carry out the terms of the trust, nor is he relieved of liability for breach; rather, his liability is *provided for* by the beneficial interest provided by the settlor.

Of course, in practical terms so far as litigation following a breach goes, the result is the same. To the extent that the trustee's liability falls within the terms of the "exemption clause," here the clause expressing the precise details of the contingency upon which the trustee's interest vests, it will be pointless for the other beneficiaries to sue. The vesting of the trustee's beneficial interest will not lead to any actual transfer of trust property to him, or provide him with any greater interest in what remains (beyond what his charging clause reserves to him or any other beneficial interest in the fund he may have). Rather, it will provide him with the sole beneficial interest in any property which he is required to add to the trust to "restore" it. In that respect, the trustee's new interest makes "legitimate" any previous receipt of trust property that came his way via the "exonerated" breach, but not in terms. The contingent interest arises in the trust asset constituted by the claim against the trustee to restore the trust. I doubt whether the beneficiaries could insist upon the actual transfer of any property into the fund, for the trustee (whether the breaching trustee himself or more likely, his successor) would, I think, be barred from pursuing anything so pointless by the principle of *Saunders v Vautier*; the interest in the claim for restoration payment would, after all, be absolutely, ie, indefeasibly, his, and being *sui juris* (one presumes) he would have the right to determine how the said property interest be dealt with.

I do not know whether such a provision would be "repugnant" to the trust, although I think it pricks our intuitions about "repugnancy" more sharply than does even the most extensive exemption clause that can be drawn on the obligational model. Why? It does so, I hazard to say, because it expresses quite straightforwardly how, through his own default, the trustee may acquire or enlarge his rights to the beneficiaries' property. It expresses in terms that in a case like this, a kind of "zero sum game," the beneficiaries' loss must be counted as the trustee's gain. The intuition underlying this, I think, is that a trustee's failure to meet his trust duties (leaving aside the genuinely onerous duty of investing the trust for a respectable return which I have isolated above) is a failure to treat the trust property as properly belonging to someone else, the beneficiaries. It is to fail to be a trustee at all, to fail as a steward of another's worldly goods in any real sense. It is to treat them in the same careless, haphazard, sloppy, foolhardy, or perverse way which the law reserves as of right to the beneficial owner in respect of his own property. And this suggests a further insight into the character of the trust and the role of the trustee according to the proprietary view: on this view, the job of the trustee is not "onerous" in the way it is so often peddled to be. Being a trustee can be time-consuming, a nuisance, but it is not onerous in the sense that complying with the terms of the trust (once again distinguishing the duty to invest) requires some special capability of dealing with property. It does not present a *challenge*, something which people for a host of

reasons might quite often fail to achieve, as they for all kinds of reasons often fail to fulfil their contractual obligations. "Keep an eye on the property and divide it up properly at the appointed times"—not rocket science. And remember that no one is required to take up the role of a trustee, and trustees are capable of retiring if it all becomes too much for them. Moreover, very much unlike the case of contract, the court of Equity positively offers its assistance to trustees whenever they are faced with a quandary about how to proceed, and by section 61 of the Trustee Act 1925 may excuse an honest trustee for making a reasonable error causing loss. From the proprietary perspective, then, it would be perverse, if not exactly repugnant to the trust, to insert such an exemption clause, for according to that perspective it is very nearly inconceivable that a person can honestly and reasonably breach the trust if he merely acts with common sense knowing that he is dealing with the property of others.

## G THE CURRENT INSTABILITY OF THE TRUST CONCEPT

The foregoing considerations strongly suggest to me that the concept of the trust as presently found in the law (and perhaps more importantly, in our general understanding of it as trust lawyers) is unstable, oscillating between an obligational and proprietary perspective. We seem to have moved from an appreciation of the flexibility of the trust to a much more dangerous "flexibility" in our characterizations of what are the trust's essential features. For example, it is not clear to me that the principle that a trust should not fail for want of a trustee can flow from an obligational understanding of a trust (voluntary obligations arise on the basis of bi-lateral transactions between persons—one cannot write a contract and insist on the law finding someone to serve as the other party to it); whereas it follows from the proprietary view, since the idea there is simply that a settlor is given the facility to make a particular kind of gift, and making a gift is essentially a unilateral act. Clearly, the limitation upon exemption clauses forms but one battleground in the war between the obligational and proprietary views of the trust. And, for the time being at least, I am not able to provide a strong justification for preferring either the obligational or the proprietary view. What I do fear, however, is that a failure to appreciate the significance of many recent trust law developments will mean that we end up with the "obligational" view by default. Far be it for me to be a stick in the mud about European integration or the reformulation of a body of law so as to serve our interests better, but I do think the proprietary understanding of the trust, if it is to go the way of the dinosaurs, ought to be given a decent burial. Whatever notions or intuitions about justice gave and give it substance, before retreating from them we are obliged as lawyers, I think, to explain to ourselves why they are now obsolete.

# 9

# *Excuses*

JOHN LOWRY AND ROD EDMUNDS

## A INTRODUCTION

WHEN A TRUSTEE is found personally liable for a breach of trust the court may exercise the discretion found in section 61 of the Trustee Act 1925 to grant partial or total relief.[1] Such relief may be available where the breach is honest and reasonable. During the fifty or so years following the enactment of this provision's predecessor in 1896,[2] defendant trustees pleaded it almost as a matter of course. It has since languished in a legal backwater.[3] Indeed the major commentaries on the law of trusts in England and Wales rarely allocate more than a page or so to the section despite the considerable weight of case law generated in the immediate aftermath of its enactment. However, its continued viability, at least in the context of the lay trustee, was recently revisited in *Re Evans (decd)*.[4] The decision is of interest for the insight it affords into contemporary judicial thinking on the scope of section 61. It also provides an opportunity to re-evaluate the scope and function of judicial relief.

## B *RE EVANS (DECD)*

The defendant was the daughter of the intestate. Subject to administration, she held her father's estate on statutory trusts for herself and her brother, the

[1] Trustee Act 1925 s 61 provides: "If it appears to the court that a trustee, whether appointed by the court or otherwise, is or may be personally liable for any breach of trust, whether the transaction alleged to be a breach of trust occurred before or after the commencement of this Act, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust and for omitting to obtain the directions of the court in the matter in which he committed such breach, then the court may relieve him either wholly or partly from personal liability for the same."
[2] Judicial Trustees Act 1896 s 3.
[3] Two notable exceptions in which section 61 is considered by courts in England and Wales are: *Re Pauling's Settlement Trusts* [1964] Ch 303 (CA); *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515 (CA); there is also cursory consideration by Plowman J in *Re Rosenthal* [1972] 1 WLR 1273.
[4] [1999] 2 All ER 777 discussed [1999] All ER Rev 234, 320–321, 385–387.

claimant, in equal shares. At the time of distribution in 1990 she had not heard from her brother for over 30 years and assumed he was dead. Acting on legal advice she purchased a missing beneficiary policy to cover approximately half the estate. This was less expensive and more effective than procuring a Benjamin order. Four years later the claimant reappeared. Although he received almost £21,000 from the policy, he sued his sister claiming, *inter alia,* accounts in respect of her maladministration of the estate. More particularly, he claimed that the policy was deficient in not providing for interest for the period after he became entitled to his share. Having been found to be liable to account for the interest, the defendant argued that she ought to be relieved from liability.

Richard McCombe QC, sitting as a deputy judge of the High Court, noted that there was no allegation that the breach had been dishonest. In the terms of section 61, what therefore fell to be considered was whether or not the defendant had acted reasonably and ought fairly to be excused. The judge concluded that the defendant should be granted partial relief. Her liability was limited to the extent that the claim to unpaid interest could be satisfied from the proceeds of sale of a house that represented an undistributed asset of the estate.[5] In line with the case-by-case approach that has epitomised the judicial use of the provision and its predecessor, determining the availability of such relief necessitated a consideration of all the circumstances surrounding the breach. In the present case, factors that favoured relief included the relatively small size of the estate and the avoidance of unwarranted expense in not applying to the court for directions. Although earlier courts have indicated that acting on legal advice is not a "passport to relief,"[6] it was found that the defendant had been reasonable in seeking and relying upon her solicitor's advice to effect insurance cover for the principal sum.

Taking one step back from the specific circumstances that influenced the court in its decision to invoke the relieving provision, the more general impression is that the case bears hallmarks that make it possible to assimilate it with the body of earlier cases on the section. This was a small family testamentary trust. The defendant was an unpaid lay person, untutored in the technicalities of the administration of estates, who was willing at all times to act in accor-

[5] It is arguable that as an overpaid beneficiary the executor's liability might have been viewed as a *Diplock* personal claim (*Re Diplock's Estate* [1948] Ch 465 (CA)) opening the door to the possibility that she might have pleaded a change of position defence rather than that under s 61: [1999] All ER Rev 320, 321.

[6] Citing Evershed MR in *Marsden v Regan* [1954] 1 WLR 423 (CA) 434–435; and see also, *Baden, Delvaux and Lecuit v Société Général pour Favoriser etc* [1993] 1 WLR 509, 609. By way of contrast to *Evans,* note the disinclination of Romer J to award relief to an executor who continued payments to the income beneficiary under the estate even after a vague creditor's claim had crystallised into a writ: *Re Kay* [1897] 2 Ch 518. Awarding the executor relief in respect of everything done prior to the issue of the writ, the judge observed (524) "It would lead to grave results if I were to hold that an executor having notice of a serious and substantial claim against his testator's estate could disregard it with impunity."

dance with professional advice to enable her to discharge her responsibilities properly.[7] It seems unsurprising that she should be relieved for a technical breach when she had behaved in objective terms quite reasonably.[8]

Modern trusts extend beyond the spheres of wills or family settlements. They reach into the realm of commerce, contribute significantly to the management of pension funds and represent an important vehicle for charity. The administration of these trusts can demand technical expertise. As one might expect trusteeship is therefore not confined to the ranks of the lay trustee found in the sphere of the small, private trust akin to the estate in *Re Evans*. Throughout the twentieth, and into the present century, there has been a discernable shift towards an increasing professionalisation of trusteeship. Section 61 may continue to provide a residual safeguard for the honest and reasonable lay trustee. However, it does not automatically follow that such relief fulfils any valuable role in respect of a professional trustee of a commercial trust.

This Chapter explores what continuing place the statutory relieving provision has in the changing world of trusts and trusteeship. Before summarising the criteria governing relief it considers its historical roots as a means of establishing its prevailing residual status. By focusing upon investment, a central administrative task of so many modern trusts, we probe the extent to which an unreformed section 61 might function. This examination draws upon the impetus provided to trustees investment powers by the Trustee Act 2000. As these legislative changes foster the perception that trusteeship is shedding its lay status in favour of being seen more as a professional and expert office, the Chapter considers an alternative potential for reform that may be inferred from the judicial operation of section 727 of the Companies Act 1985, a counterpart provision that affords protection to defaulting company directors. The final part of the Chapter focuses on the trustee as fiduciary rather than trust manager. Fiduciary duties are a significant component of modern trusteeship. They contrast with functions such as trust investments that largely depend upon the exercise of positive duties of care and skill, because breach of fiduciary duty involves equitable prohibitions that control trustee disloyalty. There is little evidence that courts in England and Wales have yet been called upon to determine when, if at all, a trustee might be eligible for judicial relief in respect of a breach of fiduciary duty. It is contended that the availability of equitable allowances for skill and labour to the trustee whose breach has yielded a profit is one important factor rendering section 61 irrelevant in this context.

[7] A similar assessment can be made of a relatively recent New Zealand administration of estates case, even though relief was there granted to a professional trustee company: *Re Te Huango* [1993] 3 NZLR 77.

[8] For a different perspective on the reasonableness of the steps taken by the defendant see P Kenny "A Lost Beneficiary Returns" [1999] Conv 375, 376.

## C CHANGING TRUSTS AND TRUSTEESHIP: VICTORIAN ANXIETIES

The nature of trusteeship underwent fundamental changes as a result of the socio-economic developments which represent the hallmark of the late eighteenth and nineteenth centuries.[9] The industrial and agrarian revolutions, colonisation and the railway boom served as the impetus for developing a more efficient and flexible trust device which would facilitate inter-generational transfer of the growing accumulation of business fortunes. Throughout the 1800s the creation of trusts steadily increased so that by the end of the century testamentary trusts for sale (disparagingly known as "traders trusts"[10]) had became common place,[11] notwithstanding that small settlements on women were rendered redundant by the Married Womens' Property Act 1882.[12]

Although the eighteenth century presaged major developments in trust law, trusts continued to be relatively simple affairs. Until the 1870s trustees were still viewed as essentially nominee property holders with little management role over trust property, much like their medieval counterparts. Land still formed the most significant asset from which regular rental income could be generated through farming leases or tenancies from year to year. By the late nineteenth century, however, the role of trustees had fundamentally changed. There had been a steep decline in the value of agricultural land from about 1875 and the Settled Land Act 1882 compounded the problem by releasing for sale many large estates.[13] Land management now became increasingly burdensome. The effect of these changes, taken together with the massive increase in commercial enterprise, was to cause the typical trust to undergo a radical change in character from which a new style of trusteeship emerged.

[9] Parallel developments are evident in the aftermath of the South Sea Company's collapse in 1720, when the legislature turned its attention to constructing a regime of company law to serve the frenetic increase in enterprise.

[10] See P Polden "The Public Trustee in England, 1906–1986: The Failure of an Experiment" [1989] JLH 228. The connection here presumably lies with the rapid increase in the ranks of the mercantile classes during the 18th and 19th centuries.

[11] It was estimated that one-tenth of the property in England (equating to some £1,000 million) was held in trust; see the Select Committee on Trusts Administration, PP 1895 (248) XIII (hereafter referred to as the Select Committee) 403, q 79 and q 593. The increased reliance on the trust was no doubt also symbolic for it "set the seal on a lifetime of respectable endeavour" thus dovetailing with the Victorian values of thrift and responsibility, Polden (above n 10) 229.

[12] The testamentary trust for sale better served the need for smooth transmission of wealth across generations in a way that the old style trust (the use, which dated from the Middle Ages), did not. The use was basically a simple conveyancing device designed to frustrate feudal restrictions on inter-generational transfers of realty. See further, F Pollock and F Maitland, *The History of the English Law Before the time of Edward 1* (CUP Cambridge 1898). Trusts for charitable purposes were also evident at this early stage in their history. Pollock and Maitland cite the example of trusts in favour of the Franciscan Order whose vow of poverty prevented its members owning property directly. See also, FW Sanders *An Essay On The Nature And Laws Of Uses And Trusts, Including A Treatise On Conveyances At Common Law; And Those Deriving Their Effect From The Statute Of Uses* (E & R Brooke London 1791).

[13] See M J Chesterman "Family Settlements on Trust" in G R Rubin and D Sugarman (eds) *Law, Economy and Society* (Professional Books Abingdon 1984) 124. See also, F M L Thompson, *English Landed Society in the Nineteenth Century* (Routledge London 1963).

Trustees thus became pro-active managers of a diverse portfolio of assets of which personalty now formed the largest part. In consequence, life tenants began to focus their attention on the returns generated by investments in utility, colonial, local authority and railway stocks as well as mortgages. The categories of authorized trustee investments were at this time also being expanded to include a less conservative range, away from land and consols to riskier investments such as bearer securities and mortgages. In consequence, trust investments were now more vulnerable to the capricious nature of the market place. Inevitably, many trustees were not always as mindful of the risks consequent upon high-return investments as they might have been and were increasingly exposed to claims in negligence should chosen investments under-perform. Trust investment in the form of mortgages also posed the potential for beneficiaries to complain that trustees had engaged in risk and speculation. The legislature responded specifically by acknowledging that trustees might normally claim to have acted reasonably where they took certain steps including taking advice on the value of the security and capping the loan at two thirds of that valuation.[14]

While the new style trust was becoming increasingly sophisticated, trustees were still, in large part, unpaid amateurs. This army of unpaid trustees moved F W Maitland to observe that "[a]lmost every well-to-do man was a trustee."[15] In the course of a series of Inner Temple lectures for the Council of Legal Education, one practitioner offered a telling and colourful pen portrait of the typical trustee of the day as being:

> some farmer . . . who from a sense of cronyship has consented to act as a trustee under the will of a neighbour with whom on market days he has often had a friendly glass. There he stands, ignorant for certain, pigheaded very likely, quarrelsome possibly, but honest, palpably honest and perspiring.[16]

Mindful of this, the courts had begun to alleviate the position of trustees in relation to the standard of care expected of them in administering trusts.[17]

[14] Introduced by the Trustee Acts 1888 and 1889 and consolidated by the Trustee Act 1893, these requirements are currently found in the Trustee Act 1925, ss 8 and 9. It is noteworthy that in these enactments the legislature established relieving provisions for trustees investing trust funds by way of mortgage which were additional to the general provision introduced by s 3 of the Judicial Trustees Act 1896. Liability and the potential for relief under one or other of these provisions spawned a number of cases, including; *Re Walker* (1890) 62 L T 449; *Re Somerset* [1894] 1 Ch 231 (CA); *Re Stuart* [1897] 2 Ch 583; *Re Dive* [1909] 1 Ch 328; *Shaw v Cates* [1909] 1 Ch 389; *Palmer v Emerson* [1911] 1 Ch 758; and *Re Solomon* [1912] 1 Ch 261.

[15] F W Maitland "Trust and Corporation" in HD Hazeltine et al (eds) *Selected Essays* (CUP Cambridge 1936) 141, 175.

[16] A Birrell QC MP *On The Duties Of Trustees* (Macmillan London 1896).

[17] See for example, *Speight v Gaunt* (1883) 9 App Cas 1 (HL), considered below n 54 . Although the courts stopped short of the subjective test suggested by Lord Hardwicke LC in *Knight v Earl of Plymouth* (1724) 1 Dick 120 (HL), 124, to the effect that a trustee should not be expected to exercise a higher degree of skill and care than that expected of the settlor himself. How a court should ascertain what the settlor's own standards were was not addressed. See, also, *Harden v Parsons* (1758) 1 Eden 145 Lord Northington LC. The courts did not disturb the settled principles governing the fiduciary duties of directors which had begun their development with the classic decision of Lord Chancellor King in *Keech v Sandford* (1726) Sel Cas Ch 61.

Nevertheless, for lay trustees the increased management role now expected of the office carried significant risks of liability. They had to ensure that those in possession obtained a reasonable income while the capital value was maintained for the remaindermen. It is here that friction often arose between the conflicting interests of life tenants and remaindermen. High income investments demanded by life tenants rarely produced much, if any, capital appreciation. On the other hand, capital appreciation demanded by remaindermen could only be secured by selecting investments producing relatively modest income. For the unpaid trustee undertaking his task out of a naive sense of chivalry the weight of these responsibilities often became all too oppressive. The point was well taken by a number of witnesses who appeared before the 1895 Select Committee,[18] whose influential Report formed the basis of the original statutory relieving power. In his evidence, Lindley LJ unequivocally accepted the accuracy of the observation put forward by the chairman, R T Reid, the Attorney General (the future Lord Loreburn), to the effect that:

> private trustees are exposed to a very rigorous rule of law; that is to say, things may be breaches of trust which nevertheless imply neither dishonesty, nor really unreasonable, conduct when looked at from a general point of view. . . .[19]

In similar vein, the representative of the Incorporated Law Society, Mr Walters, answered in the affirmative when asked:

> [d]o you not think that there is often a very great deal of injudicious investment owing to importunity on the part of *cestui que trusts* who wish to increase their income?[20]

Indeed, a cursory examination of the law reports for the late nineteenth century discloses the sheer numbers of honest, no doubt well intentioned, but overly complaisant trustees who were held accountable for losses arising from their benign conduct.

## D THE GENESIS OF SECTION 61

Set against this backdrop of rising beneficiary expectations and a consequent increase in trustee liability, it was apparent by the 1890s that the ranks of those willing to act as lay trustees was rapidly dwindling and the shortfall was being met by professionals, generally solicitors. The legal profession itself was experiencing a recession and a rising incidence of bankruptcies. Solicitors were not obliged to keep separate client accounts, enabling all too many to

[18] Note 11 above; further n 22 below and text thereto.

[19] Note 11 above q 596. Returning to the point the Committee asked (q 597): “There is a great deal, very often, of importunity on the part of *cestuis que trust*, and a great deal of embarrassment to trustees by reason of the desire, especially in small trusts, to get a larger income? Walters responded: “Yes. I have suffered from that personally in a trust . . .”

[20] Above n 11, qs 421–422.

maintain their solvency by succumbing to the temptation of dipping into trust money.[21]

Such was the anxiety which this phenomenon generated throughout the legal establishment and beyond that on 18 February 1895 the House of Commons was moved to appoint the Select Committee on Trusts Administration. It was charged with examining "the liabilities to which persons are exposed under the present Law as to the Administration of Trusts, and whether any further legislative provision might be made for securing adequate Administration of Trusts without the necessity of subjecting private trustees and executors to the risks which they now run."[22] The seriousness with which the increasing shortage of competent lay trustees was viewed is patently evident from the remarks of the Lord Chancellor when moving the second reading of the Judicial Trustees Bill, a progeny of the Committee's work:

> The old law had been very harsh indeed against trustees, and the result had been to create great difficulty in finding fit persons to take the office. Very great reluctance had been shown, in the circumstances, to undertake the duties of trustees, and the present Bill . . . would not only make a great improvement in the existing law, but would supply a want which had for a long time been severely felt.[23]

This disquiet had, of course, pervaded the Select Committee's deliberations. Lord Halsbury, in his evidence to the Committee, had remarked:

> I think . . . that one reason of the difficulty which there is in obtaining persons to act as trustees arises from the extremely severe law that has been applied to trustees. The truth is that you have frightened every responsible and respectable man out of being a trustee, as a rule; there is nobody left who will accept the office of trustee unless he is influenced by a very chivalrous spirit.[24]

He continued by emphasising the need for some relaxation of the law. Responding to the suggestion put forward by the chairman of the Select Committee to the effect that the law should excuse a trustee from liability in circumstances where he took all reasonable care and treat him as any other bailee, Lord Halsbury remarked:

[21] See, for example, *Rowland v Witherden* (1851) 3 Mac & G 568. This issue occupied much of the Select Committee's deliberations and in its Final Report (n 11 above) iv, it noted: "that much loss and consequent suffering is caused by this kind of malversation."

[22] Note 11 above. It examined eighteen witnesses including the Lord Chancellor, Lord Herschell, Lord Halsbury, Lord Watson, Lindley LJ, Lord McLaren, two county court judges and members of the legal profession.

[23] *Parl Debs* 20 July 1896. Lord Herschell, endorsing the work of the Committee and the provisions of the Bill, added: "Trustees had acted for the most part gratuitously . . . still the law held them liable, although they might have acted honestly and reasonably, if upon the strict construction of the provisions, they could be said to have committed a breach of trust. We did not so deal with any other class of agents, and we had imposed upon trustees a liability which had undoubtedly been very severely felt, and which in many cases had operated unjustly." He was "glad, therefore that [the Lord Chancellor] had taken steps to remove . . . a serious blot on our law . . ."

[24] Above n 11, q 217.

I should think so. I cannot help thinking that what is at the root of the spirit in which the law has been administered is that the courts have said, "Well, if you want to ask us, ask us and we will tell you what to do; but if you choose to set up on your own authority we will make you insure us, you must do it at your own risk." The objection to that is that that all means expense.[25]

Within 12 months of the publication of the Select Committee's report, the Judicial Trustees Bill was winding its way through the parliamentary process.[26] A relieving provision in keeping with the evidence of such eminent witnesses as Lord Halsbury and Lindley LJ was provided by section 3 of the Judicial Trustees Act 1896.

## E TRACING THE CONTOURS OF SECTION 61

With this historical perspective in mind, the sentiment underlying section 3, at least from a pragmatic perspective, is readily understandable. Trustees of many family settlements found themselves placed in a position of having to bear iniquitous burdens. In *Re Hurst* Chitty J was moved to comment that: "I know there has been an opinion of late—possibly some learned judges may have participated in it—that trustees were dealt with too severely by the old Court of Chancery."[27] The result of which, as has been seen, is that by the end of the nineteenth century it was becoming increasingly evident that people of substance and integrity were loathe to assume the obligations of trusteeship. The provision is therefore designed to afford statutory relief by allowing the court in its discretion to excuse a trustee who has committed a breach of trust. Re-enacted in section 61 of the Trustee Act 1925,[28] the provision was seen as part of a range of ongoing reforms, both judicial and legislative,[29] designed to make the office of trusteeship less onerous and so encourage a ready supply of competent lay trustees. However, not all the proposed reforms found their way on to the statute book. The Select Committee's recommendation, particularly pressed for by Lindley LJ, that trustees should be able to apply to the court to sanction "such departures from the terms of any trust as have become expedient owing

[25] Above n 11, q 220.

[26] It received Royal Assent in the autumn of 1896 and came into force on 1 January 1897.

[27] (1891) 63 LT 665, 669.

[28] There are corresponding provisions in other Anglo-Commonwealth jurisdictions such as: s 73 Trustee Act 1956 (NZ); s 85 Trustee Act 1925 (NSW); s 67 Trustee Act 1958 (Vic); and s 35 of the Ontario Trustee Act 1970.

[29] Statutory measures included: (a) Trustee Act 1888 s 8, which made the Limitation Acts applicable to non-fraudulent breaches of trust, and which, Birrell (above n 16) writing in 1896 described as "a great novelty"; (b) relaxation of the trustee's liability for the default of an agent by Trustee Act 1888 s 2; and, (c) following the Select Committee's recommendations (albeit after a delay of some 20 years), the establishment of the office of the Public Trustee by the Public Trustee Act 1906. The latter was largely attributable to the tenacious campaigning by one of the Select Committee's members, Sir Howard Vincent, who had been impressed with the work of the Public Trustee in New Zealand especially in reducing the incidence of fraud committed by trustees and their solicitors.

to altered circumstances, and are for the advantage of those beneficially interested" was not adopted.[30]

The provision was quickly before the Chancery judges in a line of cases reported within a few months of the Act's implementation.[31] From the outset it was stressed that it did not purport to reform the duties to which trustees were subject. Conduct amounting to a breach of trust before the 1896 Act remained so after it, and a trustee's liability to the beneficiaries for such breach likewise remained undiminished.[32] In essence, the provision empowers the court to determine whether in the particular circumstances of a case it is more equitable for the beneficiaries rather than the trustee to bear any loss caused by the breach of trust.

It is not proposed to review in detail all the case law on either section 61 or its predecessor.[33] For our purposes three general observations can be made. A first preliminary point takes the form of a customary caution against any attempt to categorise the cases or draw any general conclusions as to when relief will be forthcoming. A cursory examination of the relevant law reports discloses that the only overarching principle that can be safely gleaned is that the judges have consistently refused to fetter their discretion by laying down general guidelines for its exercise.[34] However, it is equally accepted that the cases may provide some guidance on the future application of the relaxing jurisdiction. This received wisdom carries with it an implicit warning that prospective trustees cannot tutor themselves in how to chart a course that amounts to an excusable breach of trust.[35]

The second general matter involves turning to consider briefly the demands of the section. To gain relief a trustee must satisfy three key conditions: honesty, reasonableness and that it is fair that the breach is excused. The requirement that all three conditions be treated as concurrent has given rise to serious doubts over the manner of its drafting.[36] The third condition in itself is relatively

[30] Note 11 above, q 457.

[31] For example, *Re Kay* [1897] 2 Ch 518; *Re Turner* [1897] 1 Ch 536; *Re Stuart* [1897] 2 Ch 583; and *Perrins v Bellamy* [1897] 2 Ch 590.

[32] However, the court may exercise its discretion to grant relief without the section being specifically pleaded: *Singlehurst v Tapscott SS Co Ltd* [1899] WN 133 (CA).

[33] For a detailed examination of the caselaw see L A Sheridan "Excusable Breaches of Trust" (1955) 19 Conv 420. Subsequent cases that refer to s 61 are: *Re Pauling's Settlement Trust* [1964] Ch 303 (CA); and *Bartlett v Barclays Bank Trust Co Ltd (No 1)* [1980] Ch 515 (CA). This does not mean that provisions with comparable terms in English company and Commonwealth trusts legislation have not received more recent consideration.

[34] See *Re Kay* [1897] 2 Ch 518, 524 where Romer J states: "I strongly desire not to narrow the effect of the Act of 1896—I think that each case must be dealt with according to its circumstances." A similar view was expressed by Byrne J in *Re Turner* [1897] 1 Ch 536, 542: "It would be impossible to lay down any general rules or principles to be acted on in carrying out the provisions of the section, and I think that each case must depend upon its own circumstances."

[35] See Sheridan (n 33 above) 421.

[36] For a contemporary viewpoint see, FH Maugham "Excusable Breaches of Trust" (1898) 14 *LQR* 159 who observed: "Only the peremptory plea of necessity could be held to excuse such a curious mode of legislation. If a law is repugnant to the public conscience, it should be altered in a definite

straightforward. In determining whether the trustee's breach is such that he "ought fairly to be excused,"[37] the court is directed to consider whether he ought to be excused both for the breach and omitting to obtain the directions of the court.[38] This latter element of fairness reflects the practical consideration that the factor of costs operates as a major deterrent against trustees who might otherwise seek the directions of the court.[39] The Select Committee recognised this concern with what it termed "litigation in miniature." Its Report noted:

> There is a statutory right in trustees to protect themselves by taking the directions of a Chancery Judge in regard to the exercise of their duties, but the fear of expense is apt to deter conscientious trustees from taking this course in a small estate. In return for the protection thus offered, the Courts of Chancery apply a more rigorous standard to the conduct of trustees than to the case of other bailees.

The matter came before the court under section 3 in *Re Grindey*.[40] The Court of Appeal readily acknowledged that the executor trustees acted fairly in declining to incur £50 in costs in order to seek directions as to whether an investment in the form of a £166 debt on a promissory note should have been called in to the estate before the debtor became insolvent. No greater difficulty lies with the legislative requirement of honesty. Honesty might at first sight seem superfluous for no court will be moved to relieve a dishonest or fraudulent trustee from liability. Rather than requiring an investigation of the trustee's probity, honesty is essentially taken to mean acting in the interests of the trust.[41]

manner: the method adopted by this section is likely to lead, not only to doubt as to its scope, but also to different practical applications of it in different courts . . . ." The judges have also expressed criticism. In *Perrins v Bellamy* [1898] 2 Ch 521 (affd [1899] 1 Ch 797 (CA)), Kekewich J subjected the wording of the section to thorough scrutiny and concluded (at 528–529) that: "I do not see how the trustee can be excused for the breach of trust without also being excused for the omission referred to, or how he can be excused for the omission without also being excused for the breach of trust. If I am at liberty to guess, I should suppose that these words were added by way of amendment, and crept into the statute without due regard being had to the meaning of the context."

[37] Some guidance here, although delivered in another context, can be gleaned from *Dundee General Hospitals Board of Management v Walker* [1952] 1 All ER 896 (HL), in which the suggestion is made that provided trustees arrive at a decision with all due care, the court will not re-open their decision however unreasonable it may appear. Lord Normand states (901): "We are concerned only with unreasonableness, but there is other evidence in the case that the trustees addressed themselves to their duty carefully, seriously and impartially, and with a real desire to perform their duty to the best of their ability. One most important fact is that they took the advice of counsel and were guided by it and acted upon it. That is powerful evidence against unreasonableness. I am not prepared to accept the view that the supposed unreasonableness of their decision or of the ground on which they reached it must outweigh more direct and satisfying evidence that they behaved as reasonable men would."

[38] Fairness is broadly seen as being about balancing the interests of the trustee with the other interested parties. It also seems that a trustee who takes reliable advice will not necessarily qualify for relief if the court considers that a prudent man of business would have acted differently in managing his own affairs: acting on legal advice is not a "passport to relief". However, there may be circumstances, such as the experience and expertise of the trustee, that fairly warrant such reliance: *Marsden v Regan* [1954] 1 WLR 423 (CA) 434–435. See also *Re Evans* (n 4 above).

[39] Note 11 above, iv.

[40] [1898] 2 Ch 593 (CA).

[41] See Sheridan (n 33 above) 423. See also, the *obiter* remarks of Thomas J in *Jones v AMP Perpetual Trustee Company NZ Ltd* [1994] 1 NZLR 690 (NZCA) 712.

The crux of the provision is therefore the requirement that the breach must be reasonable. If we put aside those cases in which the trustee acts outside his powers and is prima facie liable without regard to fault of any kind, the interesting question arises whether or not a negligent trustee who is seeking the court's relief for breach of trust can ever be said to have acted "reasonably": can a trustee be reasonable and negligent? Posed in such simplistic terms it would seem that the obvious answer would be in the negative. And yet it might be thought that the promoters of the legislation had some sympathy for the notion that technical breaches though negligent should be relieved as reasonable. In his evidence to the Select Committee, Lord Herschell, discussing the liability of voluntary private trustees, remarked:

> It is by reason of their default in point of law, and it may be said to be, in many cases, by reason of their neglect; and yet there is no doubt in my mind that there are many instances in which any reasonable prudent man might and would have acted as they did.[42]

On this approach, even where the liability arises "by reason of their neglect" trustees have some hope of demonstrating that the breach in question would have been committed no matter how prudently they had acted. Lord Herschell would evidently look favourably on relieving them. It may be that the same thought is implicit in the language of Lindley LJ in his famous reference in *Perrins v Bellamy* to "judicious" breaches of trust, although he probably meant chiefly to refer to deliberate decisions on the part of trustees to overstep their investment powers.[43] Rigby LJ was certainly moved to commiserate: "I remember well in my early days cases in which, there having been inadvertent breaches of trust involving no moral blame, the consequences were visited upon the trustees . . . and it shocked one's conscience."[44]

The paradigm of relief is *Re Smith*.[45] The widow trustee Mrs Thompson lived in Reigate. It was the trust's London solicitor's practice to complete cheques and send them to her for signature. This allowed a solicitor's clerk, well known to Mrs Thompson, fraudulently to obtain her signature to cheques that he cashed before absconding. Kekewich J held that the trustee—"the parties to the litigation themselves being more or less innocent, certainly in this case completely innocent so far as moral blame is concerned"—had acted honestly and reasonably and was entitled to relief:

> It may be that Mrs Thompson did not take all the precautions which a very careful or a very astute person might have taken, and it may be that these solicitors did not look after

[42] Note 11 above, q 161–163. D R Paling argues that the enactment of s 3 of the 1896 Act was an admission by the legislature that the standard of skill and care was in certain circumstances too high, and that the provision was so drafted so as to effect a lowering of the standard of care, see "The Trustee's Duty of Skill and Care" (1973) 37 Conv 48.

[43] [1899] 1 Ch 797 (CA).

[44] Note 43 above, 801.

[45] (1902) 86 LT 401.

their clerk, whom they trusted, so carefully as they would have done if they had acted upon the principle that no one ought to be trusted; but beyond that no possible blame can be placed upon anyone . . . . It seems to me that in whatever way this case is looked at Mrs Thompson cannot be said to have acted otherwise than reasonably, and there is therefore no reason why she should suffer.[46]

This appears to suggest that negligent but morally innocent breaches might be considered reasonable within the meaning of section 61. However, this is not borne out by the considerable body of case law that the section has generated. The more abiding legacy of the judicial working of the provision is the conclusion that trustees who fall below the required standard of prudence in the discharge of their managerial work will invariably be found not to have acted reasonably and therefore will be deprived of the benefit of relief.

This leaves one final general observation. There has been an almost total absence of judicial consideration of the provision in England and Wales in the 46 years since Sheridan mapped out its boundaries. Moreover, the overwhelming bulk of decisions his assessment draws upon were decided in the 20 or so years after the 1896 Act was implemented. No obvious explanation for this gradual decline springs to mind. There may be a link here with the extent to which the amateur trustee has been superseded by the expert and/or professional.[47] Perhaps a preference for out of court settlement rather than costly litigation has played its part, as may have the increasing incidence of trustee liability insurance.[48] Equally it may be conjectured that the decline in reported cases may owe something to the judicial recognition of the validity of wide-ranging trustee exemption clauses, invariably relied on by professional trustees.[49] Whatever the true explanation (or explanations), it is contended that the relative and increasing paucity of litigation does not of itself inexorably indicate that the section has become redundant.[50] But it does, as a minimum, provide a reason to re-evaluate what, if any, continuing role the section will and should perform.

[46] Note 45 above, 402–403. A similar line of reasoning is also discernible in the more recent Commonwealth decision in *Fales Wohlleben v Canada Permanent Trust Co* (1976) 70 DLR (3d) 257 (Can SC), in which Dickson CJ, noting that the trustee in question was not guilty of any culpable conduct, observed: "She tried to the best of her ability to keep herself informed but Canada Permanent failed to make known to her the contents of papers which were essential to informed opinion. She made all decisions which she had to make within the limits of her experience and knowledge, and I cannot find that she failed to listen or that she responded irrationally or obdurately . . . this is the very sort of case for which the section was intended. Mrs Wohlleben ought fairly to be excused from her breach of trust." Cf the New Zealand case *Re Mulligan* [1998] 1 NZLR 481, where there was a refusal to relieve (under s 73 of the Trustee Act 1973 (NZ)) an elderly and inexperienced widow trustee whose obduracy made her hostile to any suggestion by her co-trustee, a professional trust company, that there should be diversification of the trust investments.

[47] The related perception that throughout the twentieth century the standard of care (particularly of the expert and/or professional trustees in managerial matters such as investment) has become less demanding is considered further below (text associated with ns 70 and 71).

[48] See R Ham "Trustees' Liability" (1995) 9 TLI 21.

[49] See *Armitage v Nurse* [1998] Ch 241 (CA) and the Trust Law Committee's Consultation Paper, *Trustee Exemption Clauses*, 1999. See Ch 8 (Penner).

[50] As can be seen by the recent recourse to the provision in *Re Evans* (n 4 above).

Rather than analyse the judicial response to the provision by reference to the full gamut of breaches of trust,[51] it is proposed to focus solely on two types of breach. First, there will be an exploration of the past and prospective value of section 61 in the context of the trustee investment function, the challenges of which figured prominently in the minds of the provision's architects. This discussion will proceed from a review of the way in which during the lifetime of the relieving provision the common law rules on both the standard of care and the investment powers have contributed to the creation of a relatively lenient climate in which fixing expert trustees with liability has not always been easy. As a consequence there has been little need for the trustee to rely upon judicial relief.

What then needs to be considered is whether or not the reforms on investment and the duty of care contained in the Trustee Act 2000 look set to disturb this state of affairs. It is contended that at a minimum they confirm the diminishing prospect of section 61 being invoked by expert trustees. It might be thought that one possible impetus for the reconfiguration of this aspect of trusts law lies in reviewing the judicial activity surrounding the corresponding company law relieving provision available to directors. For unlike section 61, section 727 of the Companies Act 1985 has been the subject of a spate of modern cases that have responded to the requirement of "reasonableness" by promoting a subjective interpretation to the availability of relief for the errant director. If an association is made between the professionalism of trustees and company directors, there is a temptation to shape the future of section 61 by reference to the decisions on section 727. However, for reasons outlined below, this would be an inappropriate direction to take.

The second type of breach this Chapter considers is the core fiduciary duty of loyalty. It presents different challenges in gaining a clear understanding of the prospects for the modern role of the statutory relieving provision. Section 61 has not figured in leading English decisions involving innocent transgressions of this prophylactic principle.[52] In its place there has been a gradual resort to offering the trustee some financial recognition for his or her entrepreneurial skill. A common consequential thread that can be teased out of the two types of breach—investment and the honest breach of fiduciary duty—is the tangible impression that section 61 occupies a residual role. Against this realisation, the question of what, if any reform, is called for becomes all the more pertinent.

## F TRUSTEE INVESTMENT: RISING OR FALLING STANDARDS?

As we have indicated, the origins of the provision now contained in section 61 owes much to the spirit of its times, a period when substantial changes were

[51] For a fuller discussion of the operation of the relieving provision according to the kind of breach being excused see Sheridan (above n 33) 426–437.
[52] See, for example, *Boardman v Phipps* [1967] 2 AC 46 (HL).

taking place in terms of the nature of trusts, trustees and their management role.[53] The rise of investment trusts with wider administrative powers was being matched by an increasing professionalisation of trusteeship. The onerous nature of trusteeship was further underlined by the limited scope in law to delegate investment matters to others. The judicial relieving provision was in part designed to allay an anxiety that it would prove too difficult to persuade friends and family members to continue to serve as trustees if they became exposed to the higher risks of trusteeship without protection. It should also not be forgotten that through the final quarter of the nineteenth century the courts were gradually fashioning a higher standard of care to govern trustee investment. Thus, after the Court of Appeal delivered its decision in *Speight v Gaunt,*[54] it became settled law that in management matters other than investment, a trustee should exercise the same degree of care that an ordinary prudent man of business would exercise over of his own affairs.[55] There was even some support for greater relaxation in the law. Responding to the 1895 Select Committee, Lindley LJ seemed to favour cautious development of the law to offer trustees further relief:

> I personally go as far as I dare, with the House of Lords above one, you know. I may take a little credit to myself, because that case of *Speight v Gaunt* was decided by the late Master of the Rolls, Lord Justice Bowen, and myself. It was thought a little bit of a stretch, but the House of Lords upheld us; and, so encouraged, we might go a little further next time.

But it is not easy to reconcile this extra-judicial observation with the same judge's stricter formulation of the standard of care for trustee investments three years after *Speight v Gaunt*. In a celebrated judicial statement of the requirement, Lindley LJ explained:

> The duty of a trustee is not to take such care only as a prudent man would take if he had only himself to consider; the duty rather is to take such care as an ordinary prudent man would take if he were minded to make an investment for the benefit of other people for whom he felt morally bound to provide.[56]

[53] See also, G Moffat *Trusts Law Text and Materials* (3rd edn Butterworths London 1999) ch 9; and Polden (above n 10).
[54] (1883) 22 Ch D 727 (CA) (affd (1883) 9 App Cas 1 (HL)), holding that a trustee was not liable to the trust for the losses it sustained when a broker misappropriated some £15,000 of trust money with which he had been entrusted by the trustee in order to purchase stock. Paying over the money in this way when purchasing securities accorded with standard business practice. Jessell MR said (740–741): "a trustee is not bound because he is a trustee to conduct in other than the ordinary and usual way in which similar business is conducted by mankind in transactions of their own. It could never be reasonable to make a trustee adopt further and better precautions than an ordinary prudent man of business would adopt, or to conduct the business in any other way."
[55] Above n 11, q 554. Cf Paling (above n 41), who comments that considering trustees were under a duty to act gratuitously, the duty of care and skill remained extremely onerous.
[56] *Re Whiteley* (1886) 33 Ch D 347 (CA) 355; endorsed by Lord Watson on appeal (*Learoyd v Whiteley* (1887) 12 App Cas 727 (HL) 733). See Nicholas Warren QC "Trustee Risk and Liability" (1999) 4 TLI 226, 227. Cf the statement of the duty in Law Commission, *Trustees' Powers and Duties* (Law Com No 260) 1999 para 2.14.

In effect, early decisions synchronised the prerequisite that the breach should be reasonable with this recently fashioned standard of care. So, in *Re Stuart*,[57] Stirling J drew a synergy between section 3 and the prevailing standard of care of trustees. He stated that no trustee ought fairly be excused for breach of trust unless he satisfied the court that he conducted himself according to the ordinary prudent man acting in the conduct of his own affairs. The judge said that a trustee must prove:

> that he has acted reasonably; and certainly, it is fair in dealing with such a question to consider whether [the trustee] would have acted with reference to those investments as he did, if he had been lending money of his own . . . I think a man in dealing with his own money would not act upon the opinion of his solicitor alone in a question as to the value of property proposed as a security though, no doubt, he might do so as to any question of title or law which may be involved.[58]

Taken without more, this might be thought to place section 61 in a location where it plays little more than a residual role—for if a trustee can prove that he has met the standard of the prudent business person, no issue of breach arises. Yet if a trustee, having acted prudently, committed some technical breach, section 61 would be available. Therefore, while it may not be possible or desirable to distil general guidelines about its operative effect, there seems to be some merit in the finding that the section should not assist a trustee whose stewardship of the investment function has been imprudent. A double advantage that flowed from this synergy is that the law developed a transparent approach and one that marked a sensible balance between protecting beneficiaries and trustees. Such a balance was also in keeping with the underlying rationale identified by the Select Committee when it found that the greatest need was to ensure the continued viability of gratuitous trusteeship.

In the management of investments, the same correlation between the reasonableness inherent in the duty on the one hand, and section 61 on the other, can be identified in the context of one of the few relatively modern decisions that touches upon the provision. In *Bartlett v Barclays Bank Trust Co Ltd (No 1)*,[59] the imprudence amounted to the trustee bank's failure to take appropriate steps to monitor the property development activities of a company in which the trust held almost all the shares. Brightman J's judgment barely touches the terms of section 61, largely because it must have seemed self-evident that though honest, the trustee could not be said to have behaved with the care of the ordinary prudent business person looking after the affairs of another. In which case it was

[57] [1897] 2 Ch 583. See also the approach in *Re Grindey*, (text to n 40 above).
[58] Note 57 above, 590–591. See also the judgment of Byrne J in *Williams v Byron* (1901) 18 TLR 172 who stated: "The provisions of the section were intended to enable the court to excuse breaches of trust where the circumstances of the particular case show reasonable conduct, but it was never meant to be used as a sort of general indemnity clause for honest men who neglect their duty, and if it were so applied as to shake or weaken the clear rules of the court in reference to the conduct of trust matters, it would, I believe, result in greater evils than those it was intended to remedy."
[59] [1980] Ch 515 (CA).

untenable to plead that the bank should come within section 61's conception of having committed a reasonable breach.

*Bartlett* is more often cited nowadays for its contribution to the debate on how far the standard of care should differ according to the status of the particular trustee.[60] The impression, that paid trustees owe a more exacting standard of diligence is based upon dicta expressed in *Re Waterman's Will Trusts,*[61] in which Harman J said: "I do not forget that a paid trustee is expected to exercise a higher standard of diligence and knowledge than an unpaid trustee."[62] However, there seems to be no reported case in which this "higher" standard of care has formed the ratio of the decision. Were it possible, let alone desirable, to articulate an appropriate standard,[63] and agree the different categories of trusteeship,[64] the question that remains is the extent to which any such differentials can and should impact upon the operation of section 61. There is no automatic bar on paid professionals being eligible for relief.[65] Even if the authorities tend to suggest that the court may be less sympathetic towards paid trustees,[66] the English courts do not yet seem to have had recourse to a higher standard of care.[67] In any event, it is arguable that the degree of care required need not substantially disturb a sense of equilibrium between the operation of the duty and

[60] Note 59 above, 534. Oakley points to this as authority for the proposition that a higher standard of care is owed by paid trustees, see A J Oakley *Parker and Mellows: The Modern Law of Trusts* (7th edn Sweet & Maxwell London 1998) 492. See also, J E Martin *Hanbury and Martin Modern Equity* (16th edn Sweet & Maxwell London 2001) 500.

[61] [1952] 2 All ER 1054.

[62] Note 61 above, 1055.

[63] Romer J expressed his support for a common standard of care for both lay and professional trustees in *Jobson v Palmer* [1893] 1 Ch 71, 76: "I see no sufficient reason for confining the principle laid down in *Speight v Gaunt* to cases where the trustee is unpaid, though, no doubt, some of the Judges who decided *Speight v Gaunt* did in their judgments refer to the fact that there the trustee was not paid for his services. I think the principle ought to be applied in a proper case even where the trustee is remunerated . . ." See, further, JE Penner *The Law of Trusts* (2nd edn Butterworths London 2000), 288 ff.

[64] Classifying trustees by reference to factors such as reward and expertise is more than terminologically difficult: Moffat (n 53 above) 342. The Law Reform Committee 23rd Report *The Powers and Duties of Trustees* (Cmnd 8733, 1982) paras. 2 12–2 16, classified trustees into three groups: (i) unprofessional unpaid trustees of the "family friend" type; (ii) paid, often professionally qualified, trustees such as solicitors and accountants; and (iii) professional trustees, such as banks, who advertise themselves as such. More recently the Law Commission refereed to the "unpaid layman, a paid professional or a professional trustee who holds him or her out as such": Law Com 260 (above n 56) para 3 24(3).

[65] Although it is one of the factors to be taken into account: *National Trustees Company of Australasia Ltd v General Finance Company of Australasia Ltd* [1905] AC 373 (PC) 381.

[66] This may account for Plowman J's refusal in *Re Rosenthal* (n 3 above) to grant relief to the professional (solicitor) trustee for an unreasonable breach of trust in paying estate duty from the residuary estate. Partial relief was however granted to a trustee bank in *Re Pauling's Settlement Trusts* (above n 3). See also, in the context of s 73 of the Trustee Act 1973 (NZ), *Re Te Huango* (above n 7). Cf the refusal to find a professional trust company's behaviour reasonable within s 73 in *Re Mulligan* (above n 46) 507.

[67] In *Re Mulligan* (above n 46) 500, Panckhurst J appears to have assumed without discussion that the ordinary standard of prudence should be equally applicable to a trustee company as to the "family" trustee.

the relieving jurisdiction. If a higher standard is prescribed for the professional trustee, all that the court needs to do is interpret "reasonable" in section 61 by reference to the same standard. In that way a comparable synergy can be maintained.

However, in reality, focusing simply upon the changing status and experience of trustees is to risk missing the wider twentieth century context in which trustee investment practice has not been facilitated by the law. Various problems are well documented.[68] They include the Trustee Investment Act 1961's constraining and outmoded statutory conception of the powers of investment available to trustees of modern trusts.[69] Trustees faced a further obstacle to the effective discharge of the ever increasing specialist investment function in the form of an unhelpful prohibition on delegation. In practice this might have inevitably forced trustees to at least consider the commission of a breach of trust in order to ensure fulfilment of the overriding duty to maximise the financial return to the trust. From an opposing standpoint, it might be argued that the law has not served trusts well in finding paid trustees liable in the execution of the investment function. This is most graphically illustrated by *Nestlé v National Westminster Bank plc*.[70] Leggatt LJ, far from acknowledging the existence of any higher standard, lamented the pitifully low standard of care (expressed in the terminology of *Speight v Gaunt*) that was expected of the bank. He said: "But by the undemanding standard of prudence the bank is not shown to have committed any breach of trust resulting in loss."[71] To this extent the deficiency lies more in the unchallenging dictates of the duty of investment itself than with trying to formulate the appropriate standard of care to be applied to the professional or expert trustee.

All these are indicators of the dynamic nature and needs of trusts and trusteeship and the premium to be placed on the law keeping pace with social and economic developments. This much has something in common with the needs which, at the end of the Victorian era, prompted the calls for the creation of the current statutory relieving provision. A century later, it is to be hoped that the Trustee Act 2000 will more than adequately address these various

[68] The matters are dealt with fully in a recent Law Commissions' Report (n 56 above) para. 1.1: "However, the law governing the powers and duties of trustees has not kept pace with the evolving economic and social nature of trusts—indeed the default powers which trustees have under the present law are generally regarded as seriously restrictive." See also D Hayton "English Fiduciary Standards and Trust Law" (1999) 32 Vanderbilt Journal of Transnational Law 555, 556–570.

[69] In the wake of Professor Goode's Report of the Pension Law Review Committee, 1993 (Cm 2342–1), wider powers were made available to trustees of occupational pension schemes by s 34(1) of the Pensions Act 1995.

[70] [1993] 1 WLR 1260 (CA). Distinguished in *Re Mulligan* (n 46 above) where the breach amounted to a failure to invest any part of the fund by reference to the need for capital growth, as opposed to the alleged breach in *Nestlé,* which in essence was a failure to maximise the growth in the capital value of the fund. As an illustration of a New Zealand trust corporation whose performance was not adjudged to be imprudent, but where loss was sustained by the stock market crash of 1987; see *Jones v AMP Perpetual Trustee Company NZ Ltd* (n 41 above).

[71] Note 70 above, 85.

concerns.[72] Apart from liberalising and updating the trustee's default powers for investment,[73] the new legislation modernises the rules on collective delegation.[74] These form valuable foundations to support the professional trustee in the administration of the modern trust, as does the provision of a new and precisely defined statutory standard of care. Section 1 of the 2000 Act makes explicit reference to the need to exercise such care and skill as is reasonable in the circumstances having regard to any specialist knowledge, experience or professional status of the particular trustee.[75] For the purposes of investment this removes any confusion in the common law as to the existence of a higher standard of care for professional trustees.[76] But, irrespective of this detail, with the level of duty being more explicitly framed and settled in meaning, there is less to divert attention from considering the continued purpose of section 61 of the 1925 Act. If the idea of a synergy between duty and relief previously canvassed is to be preserved, then the professional trustee who fails to meet the uniform standard with its subjective element should not be able to claim that he or she has acted reasonably under section 61. The codification thereby offers a robust but flexible mechanism that is capable of a satisfactory working relationship with the traditional relieving provision. However, if the accent is placed upon the rising professionalism of trusteeship then an alternative direction for the operation of section 61 might be discerned by reference to the current regime governing the relief for the remunerated company director.

## G THE COMPANY LAW PERSPECTIVE: RELIEVING DIRECTORS

The wording of section 61 is replicated in section 727 of the Companies Act 1985. Although there is a dearth of case law on the provision, some parameters

[72] Implementing the reforms advocated in Law Com No 260 (above n 56). Identifying investment as the primary task of trustee administration, the Law Commission's Report (para. 1.2) highlights specific recent changes in technology and fund management practice that made the need for reform "pressing and immediate" because they amount to fundamental developments in how investment practice is conducted. See J Garton "Trustee Act 2000" (2001) 15 TLI 34.

[73] Subject to various safeguards, s 3 of the Trustee Act 2000 in effect introduces a general power of investment unless some contrary restriction exists in the trust deed: s 6(1)(b).

[74] Allowing for the first time the delegation of investment powers (non-charitable trusts) or ministerial acts of investment (charitable trusts): s 11 of the 2000 Act.

[75] This is designed to ensure a standard that can afford protection against both the incompetent amateur and also the expert who holds himself out as having particular skills. Thus, "[e]very trustee should be required to exercise such care and skill as is reasonable in the circumstances. However, the level of care and skill which is reasonable may *increase* if the trustee has special knowledge or skills, or holds him or herself out as having such knowledge or skills), or if the trustee is acting in the course of a business or profession" Law Com No 260 (n 56 above) para 3.24(2).

[76] It may even be that the legislation can be said to have codified the common law duty of care more generally: see Garton (above n 72) 37 (n 41). An analogous development can be seen in the context of the wrongful trading provision contained in s 214 of the Insolvency Act 1986. This was taken by Hoffmann J to represent the current approach to be adopted to the common law standard of care to be applied to company directors: see, *Norman v Theodore Goddard* [1991] BCLC 1028, 1030–1; *Re D'Jan of London Ltd* [1993] BCC 646, 648. See also, the Law Commission, *Company Director: Regulating Conflicts of Interests And Formulating A Statement of Duties* (Law Com No 261 1999).

surrounding the type of conduct for which relief will be denied have emerged.[77] As with section 61, the director seeking relief from liability must prove honesty. In *Re Welfab Engineers Ltd*,[78] the directors of a company which had been trading at a loss sold its principal asset for the lower of two competing bids on the understanding that the company would continue to be run as a going concern. Shortly afterwards the company went into liquidation and the liquidator brought misfeasance proceedings against the directors. It was held that the directors had not acted in breach of duty in accepting the lower offer, but even if they had, it was a case in which relief would be granted under section 727. Hoffmann J took the view that the directors were motivated by an honest and reasonable desire to save the business and the jobs of the company's employees.

This approach illustrates two points. First, the requirement of reasonableness contained in section 727, as with its counterpart in the Trustee Act 1925, has the potential to present the judges with the apparent conundrum of finding negligent conduct reasonable. Second, and diverging from the trusts' caselaw, the decision exemplifies a willingness to dilute the objective character of the concept of reasonableness in determining the availability of directorial statutory relief. This tendency is also present in Hoffmann LJ's judgment in *Re D'Jan of London Ltd*,[79] where he fashioned a solution based upon a subjective consideration of the director's conduct. A straightforward proposal form for property insurance contained numerous factual errors. The insurers subsequently repudiated liability on the policy when the company claimed for fire damage. The controlling director had signed the proposal without reading it. Hoffmann LJ thought that it was the kind of mistake that could be made by any busy man. In granting the director partial relief from liability, the court had regard to the fact that he held 99 of the company's shares (his wife held the other), and therefore the economic reality was that the interests the director had put at risk were those of himself and his wife. The judge observed:

It may seem odd that a person found to have been guilty of negligence, which involves failing to take reasonable care, can ever satisfy the court that he acted reasonably. Nevertheless, the section clearly contemplates that he may do so and it follows that

[77] The courts will not grant relief where directors have abused their position for financial gain. In *Neptune (Vehicle Washing Equipment) Ltd v Fitzgerald (No 2)* [1995] BCC 1000, a sole director, in breach of his fiduciary duties, had secured company resolutions in order to obtain the payment to himself of £100, 892 for the termination of his service contract. He could not be said to have acted reasonably. Similarly, relief was refused in *Guinness plc v Saunders* [1990] 2 AC 663 (HL), on the basis that it was out of the question to relieve a director who retained £5.2m paid to him, allegedly by way of remuneration by the company, under a void contract. In *Re Duckwari plc (No 2)* [1998] 2 BCLC 315 (CA) the point was made obiter that a director who intends to profit by way of a direct or indirect personal interest in a substantial property transaction could not be said to have acted reasonably and therefore would be denied relief under s 727. See also *Coleman Taymar v Oakes* [2001] 2 BCLC 749.

[78] [1990] BCLC 833.

[79] [1994] 1 BCLC 561. See also, *Re Brian D Pierson (Contractors) Ltd* [1999] BCC 26, 48 in which Hazel Williamson QC, sitting as a deputy High Court Judge, applying *Re D'Jan of London Ltd* observed that: "'reasonableness' for the purpose of s 727 must be meant to be capable of being satisfied by something less than compliance with the common law standard of care in negligence."

conduct may be reasonable for the purposes of section 727 despite amounting to lack of reasonable care at common law.[80]

On the reasoning in these two decisions,[81] the court can take into account considerations such as a director's duty to corporate stakeholders, and the degree of culpability of his or her conduct when determining whether or not it is reasonable and therefore excusable.[82] In the latter type of case, an honest but negligent director might therefore be relieved from liability provided the negligence in question was not gross but the kind of thing that could happen to any busy person. Subjectivity also significantly and peculiarly coloured the interpretation of section 727 of the trial judge in *Re Simmon Box (Diamonds) Ltd*.[83] Peter Smith QC, sitting as a deputy judge of the Chancery Division, expressed the view that section 727 is designed to achieve fairness as between wrongdoers. The judge thought it fair to grant partial relief to a 19-year-old director against the consequences of the actions, which were not caused by any direct fault on his part, but arose from the conduct of his father in whom, it was found, he reposed too much trust.

The notion that the provision provides a mechanism for apportioning liability between wrongdoers may have its attractions. It certainly appears to mark a judicial attitude to the factors that should be weighed in determining relief that has no obvious comparator in the jurisprudence that has been built up around section 61.[84] This and the subjective overlay that has been given to the require-

[80] Note 79 above, 564.

[81] Endorsed at first instance in *Bairstow v Queens Moat Houses plc,* [2000] 1 BCLC 549. Nelson J (at 560) took the view that the test cannot be the same for deciding whether a director should be excused from personal liability as that used for deciding whether he is liable in the first place for negligence, default, or breach of trust because: "s 727 would rarely if ever operate where a director had been found honest but negligent." However, on appeal, Robert Walker LJ roundly rejected this approach in an unreasoned *obiter dictum*: [2001] 2 BCLC 531, 550. The issue has also come to the fore in relation to the wrongful trading provision, s 214(1) of the Insolvency Act 1986. By way of defence to such a claim, s 214(3) provides that the court will not hold a director liable if, once he found himself in a position where he knew or ought to have known that the company was going into insolvent liquidation he took every step with a view to minimizing the potential loss to the company's creditors. The facts which a director ought to know or ascertain for the purposes of s 214(3) are determined predominantly by way of objective assessment (s 214(4) refers to "a reasonably diligent person" as the principal criteria). In *Re Produce Marketing Consortium Ltd,* (1989) 5 BCC 569, Knox J examined the inter-relationship between s 727 and the wrongful trading provision. He observed (at 604) that s 214 contains sufficient safeguards for the protection of directors and that the provision could not be easily accommodated with the "essentially subjective approach that s 727. . . requires." See also, *Re Brian D Pierson (Contractors) Ltd* [1999] BCC 26 in which the court held that s 727 did not apply to a wrongful trading claim because Parliament did not intend both s 214 and s 727 of the respective statutes to be operated by the same judge at the same time.

[82] Gross negligence is therefore not excusable. In *Dorchester Finance Co Ltd v Stebbing* [1989] BCLC 498, two directors who had been negligent in signing blank cheques which allowed a third director to act as he pleased, were held not to have acted reasonably and therefore ought not to be excused.

[83] [2000] BCC 275. The point was not argued in the Court of Appeal and Chadwick LJ declined to express an opinion on the correctness or otherwise of the judge's opinion: *Cohen v Selby* [2001] 1 BCLC 176 (CA).

[84] In refusing relief in *Re Mulligan* (n 46 above) the court was scrupulous in dealing independently with the professional and lay trustee.

ment of reasonableness in section 727 prompts the broader question of how far the identical language in the two sections can and should be interpreted in the same way. In turn this touches upon the extent to which the directorial relieving jurisdiction offers the most appropriate blueprint to finding a suitable future direction and role for section 61. After all, the Trustee Act 2000 is a cogent reminder that trustees may nowadays more often be chosen and rewarded for their professional expertise than was the case in 1896.

Directors and trustees also share a fiduciary status. As *Re D'Jan of London Ltd* illustrates, in reality a director may be the controlling shareholder and therefore own the company. Moreover, the traditional perspective that the director owes duties to the company alone has itself come under pressure from both scholars and legislative provisions in a number of respects. To give but one example, section 309 of the 1985 Act imposes a statutory duty upon directors to have regard to the interests of the company's employees in general. Such wider considerations and interests may amply justify a more relaxed and flexible approach to eligibility for relief where there has been a directorial breach of duty. It does not follow that the same is ever true of a trustee who is negligent in the discharge of investment duties (or who is in breach of a core fiduciary obligation). The primacy of the beneficiaries' financial well-being should dictate that the availability of relief should not be made to turn on such subjective factors. If company directors do not provide the optimum analogy for the application of section 61 to commercially orientated trusts, it leaves open the question of what future there is for the provision.

Before approaching this matter, it is instructive to counterpoise our discussion of the continued prospects for section 61 to operate in the modern world of trust management with a consideration of the value of the provision to the trustee who is in breach of a fiduciary obligation. It is well documented that ameliorating the anticipated burdens of trust management motivated the introduction of the statutory progenitor of section 61. Transgressing fiduciary duties does not seem to have impinged upon the consciousness of the architects of the legislation. Their principal concern was to provide aid for the lay trustee who might become innocently ensnared by the changing pace and expertise that managing trustee investments increasingly required. It is not simply that this sphere of operation is now of less moment. Rather, what has also to be borne in mind is the emergent strand of influential judicial thinking that clearly demarcates the trustee's fiduciary obligations of loyalty from his or her managerial duties such as investment and delegation.[85] These latter functions are

[85] See, most notably, Millett LJ's pronouncement in *Bristol and West Building Society v Mothew* [1998] Ch 1(CA) 18: "Breach of fiduciary obligation, therefore, connotes a disloyalty or infidelity. Mere incompetence is not enough. A servant who loyally does his incompetent best for his master is not unfaithful and is not guilty of a breach of fiduciary duty."; consider, also, the High Court of Australia in *Macquire v Makaronis* (1997) 71 ALJR 781 (HCA) 703. See further, R C Nolan "Conflicts of Interests, Unjust Enrichment, and Wrongdoing" in W R Cornish, et al *Restitution Past, Present and Future: Essays in Honour of Gareth Jones* (Hart Oxford 1998) 87, 88: "Not all

increasingly located as tortious duties laid upon trustees rather than breaches in equity of a core fiduciary duty.[86]

## H MAKING ALLOWANCES

There is no reported English decision in which trustees have successfully relied upon section 61 to gain relief for breach of their core fiduciary obligations. More than that, there is precious little evidence that the section has been judicially discussed at all in this context.[87] On one level this is unsurprising both in terms of policy and principle. Looking to the statutory language of section 61, it is not immediately apparent how any trustee who has deviated from the fiduciary terms of his or her trust might expect to come within its requirements of "honesty," or "reasonableness," or be able to justify that there is a basis upon which he or she should be fairly excused. Reading the section in this way might also be said to sit well with the prophylactic intentions of the fiduciary ideal, by discouraging all such deviations from duty. On the other hand, such a blanket approach to the unavailability of statutory relief for such breaches can be questioned for failing to distinguish between an honest and dishonest breach of fiduciary obligation.

Nobody would countenance section 61 arguments being appropriate to sustain relief for the covert and criminal behaviour evident in such cases in *A-G Hong Kong v Reid*.[88] By contrast, greater reflection might be in order when recalling the honest and industrious activities of fiduciaries such as the solicitor and beneficiary who were called to account in *Boardman v Phipps*.[89] Through their entrepreneurial tenacity and acumen over a considerable period they intervened in the affairs of Lester & Co to turn around its fortunes, thereby advancing both their own wealth and that of the trust, which held a large minority shareholding. In so doing, they fell foul of the fiduciary's duty of loyalty, allowing their personal interest to conflict with their fiduciary duty. Having profited from their position, the hypothetical question arises: should their breach be capable of attracting the relieving jurisdiction in section 61? The question is hypothetical, because there is no indication that the section was canvassed at

those duties which affect someone properly called a fiduciary are themselves fiduciary duties. For example, duties of care and skill are laid on the trustees and on company directors, yet such duties are not fiduciary duties, albeit that they affect those properly described as fiduciaries. Fiduciary obligations promote loyalty by prohibiting disloyalty, and activity which might lead to disloyalty: fiduciary obligations are proscriptive in nature, and do not encompass the positive duties laid on those described as fiduciaries" (footnotes omitted).

[86] See Ch 2 (Getzler).

[87] It seems there is one ill-reported twentieth century case, mentioned by Sheridan (n 33 above), 434 in which relief was denied for breach of what might now, adopting Megarry V-C classification in *Tito v Waddell (No 2)* [1977] Ch 106, be termed the self-dealing rule: *Re Clark* (1920) 150 LTJ 94.

[88] [1994] 1 AC 324 (PC).

[89] [1967] 2 AC 46 (HL).

any stage of the proceedings in *Boardman*.[90] An obvious explanation for this omission is to be found in the fact that as one of the fiduciaries was a beneficiary and the other the trust's solicitor, neither was a trustee for the purposes of the statute.[91] If they had been trustees, they might have pointed to the undisputed facts that their integrity was never impugned, and their motivation, at least in part, was a desire to promote the interests of the trust. It might then have been argued that no good reason in fact or law existed to exclude them from the possibility of statutory relief.

Of course, on the conventional wisdom of its rationale, section 61's conception of relief is primarily focused upon assisting the inept trustee whose breach has occasioned a loss to the trust. In cases such as *Boardman,* the errant but industrious fiduciary invariably shows a profit. It becomes less obvious how consideration of the profitable breach of fiduciary duty should be located within the ambit of section 61. This may help to explain why in place of considering the applicability of the statutory relieving regime, the court instead may have to determine whether or not to satisfy a fiduciary's claim to be paid for the skill and labour that he or she contributed in making the profit that is now subject to disgorgement. At first instance in *Boardman*, Wilberforce J noted that, although authority on the point was scant, the transaction (taking control of Lester & Co) was of a "special character calling for the exercise of a particular kind of professional skill" and therefore "[i]t seems to me that it would be inequitable now for the beneficiaries to step in and take the profit without paying for the skill and labour that produced it."[92]

Support for making such an equitable allowance gained significant endorsement in the appellate court's determination of the case;[93] and the existence of the jurisdiction has received favourable consideration in subsequent decisions.[94]

[90] Similarly, it seems that the precursor to s 727 of the Companies Act 1985 (s 448 of the Companies Act 1948 ) was not pleaded on behalf of the profiteering directors in *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n (HL). See further, J Birds "The Permissible Scope of Articles Excluding the Duties of Company Directors" [1976] MLR 394, 397.

[91] Even if were permissible to identify their liability as to some extent depending upon a constructive trust there seems no reason why non-express trustees should be considered to fall outwith s 61. Some support for such a contention may be gleaned (directly) from s 68(17) of the Trustee Act 1925, (indirectly) from both *Re Clarke* (1920) 150 LTJ 94 and also, possibly, *Baden, Delvaux and Lecuit v Société Général pour Favoriser etc* [1993] 1 WLR 509, 609. Support also exists in the academic literature: G Elias *Explaining Constructive Trusts* (Clarendon Press Oxford 1990) esp 20; but cf the more equivocal assessment made by R Chambers *Resulting Trusts* (Clarendon Press Oxford 1997) 211 ff.

[92] [1964] 1 WLR 993, 1018.

[93] Explicitly in the House of Lords (n 89 above) 104 (Lord Cohen) and 112 (Lord Hodson). For the Court of Appeal, see [1965] Ch 922, 1020–21 (Lord Denning MR.) and 1030–1 (Pearson LJ). By contrast, Russell LJ sounded a more cautious note, 1032: "The plaintiff accepts that they should receive reward on a liberal scale for what they have done. Without intending to throw doubt on their right to this, I would prefer not to express any view on the law under that head, since the question of their right has not been the subject of argument before us."

[94] See, for example, *Estate Realties Ltd v Wignall* [1992] 2 NZLR 615; *O'Sullivan v Management Agency and Music Ltd* [1995] QB 428 (CA); *Cheese v Thomas* [1994] 1 WLR 129 (CA); *Warman International Ltd v Dwyer* (1995) 182 CLR 544; *Maguire v Makaronis* (1997) 71 ALJR 781; and *Nottingham University v Fishel* [2000] ILRL 471.

Doubts remain on some aspects of the jurisdiction. These include two interrelated uncertainties, the first about the precise applicability of an allowance to the company director in breach of a fiduciary duty,[95] and, the second concerning what exceptional circumstances have to exist before any allowance will be granted. These matters are explored in an Australian case, *Warman International v Dwyer,*[96] where the court went beyond making an allowance in the strict sense, by deciding to split the profit between the director fiduciary and his principal. Drawing a distinction between the fiduciary who obtains a specific asset in breach and one who acquires and operates a business, the court observed:

> In the case of a business it may well be inappropriate and inequitable to compel the errant fiduciary to account for the whole of the profit of his conduct of the business or his exploitation of the principal's goodwill over an indefinite period of time. In such a case, it may be appropriate to allow the fiduciary a proportion of the profits, depending upon the particular circumstances. That may well be in the case when it appears that a significant proportion of an increase of profits has been generated by the skill, efforts, property and resources of the fiduciary, the capital which he has introduced and the risks he has taken so long as they are not risks to which the principal's property has been exposed. *Then it may be said that the relevant proportion of the increased profits is not the product or consequence of the plaintiff's property but the product of the fiduciary's skill, efforts, property and resources.*[97]

The italicised extract from *Warman* identifies one explanation for the underlying rationale for making allowances in equity. The court takes the view that only such proportion of the profit arising from the breach should be disgorged and not any other profit attributable to the work and skill of the fiduciary. An alternative explanation of the allowance works from the premise that:

> This species of action is an action for restitution such as Lord Wright described in the *Fibrosa* case. The gist of it is that the defendant has unjustly enriched himself, and it is against conscience that he should be allowed to keep the money.[98]

Whichever of these expositions provides the better view of the basis of the modern equitable jurisdiction,[99] they share a common feature. Both perspectives accentuate the need for the fiduciary to receive his or her just financial deserts. Awarding an allowance reflects payment for the service provided by the trustee,

[95] See Lord Templeman in *Guinness plc v Saunders* (above n 77) 694; Lord Goff, 701, left the point open. *Cf Kishimoto Sangyo Co Ltd v Akihira Oba* [1996] 2 HKC 260; and *Warman International Ltd v* Dwyer (1995) 182 CLR 544.

[96] (1995) 182 CLR 544. See P Jaffey "Accounting For Wrongful Profits" [1996] LMCLQ 462.

[97] Above n 96, 561 (emphasis supplied). The willingness to order a profit-sharing arrangement was said to turn upon (a) the defendant being able to show the inequity of ordering an entire account of the profit; and (b) an antecedent arrangement for profit-sharing. Otherwise the defendant would be confined to claiming an equitable allowance. See also *O'Sullivan v Management Agency and Music Ltd* [1995] QB 428 (CA). In *Warman* the availability of an allowance was said to turn upon the defendant establishing the inequity of awarding an account of the entire profits.

[98] Above n 93, 1020 (Lord Denning MR). See further P Birks "Restitution Without Counter-Restitution" [1990] LMCLQ 330.

[99] See generally G Virgo *Principles of the Law of Restitution* (OUP Oxford 1999) 536–537.

even though the service relates to the breach of his or her fiduciary duty. As this in effect involves a "causation" type investigation, it does not do violence to the deterrent function of the fiduciary duty of loyalty.[100] All this is quite different from the true function and basis of the statutory formulae in section 61 where the principal enquiry is whether or not the wayward but honest trustee's liability should be reduced in part or eliminated in full. There is no question of attributing a monetary value to the labour and skill that has been offered. The investigation aims to determine what, if any, degree of exoneration is permissible. In this way it is possible to distinguish between the purpose and operation of the section and the equitable regime. In cases where the trust reaps a profit through the expert endeavour of an honest trustee it seems much more sensible and coherent to consider what allowance there should be for his or her labour than to manipulate the language of relief in section 61 to offer indirect payment for the work done. It is possible to identify one further significant difference between the statute and equity. The flexibility inherent in the equitable jurisdiction enables the honesty of the fiduciary to play an important (but not definitive) role in influencing how liberal the allowance should be. In some instances this means that the fiduciary is entitled to recover less than full value for the services he or she has proffered because his or her dealings may not have been scrupulously honest.[101] By contrast, the dishonest trustee is never eligible for relief under section 61; nor should he or she be.

With these differences in mind, it is difficult to shape any overlap between the equitable allowance and the relieving provision. This is not to say that the trustee should be automatically precluded from the terms of the section simply because the breach is of a fiduciary nature. Indeed it remains to be seen if, in the future, the courts will be called upon to wrestle with the eligibility of a claim under section 61 on behalf of trustees whose prodigious and honest activities have resulted not in a profit but a loss to the trust. Yet if a trustee who is in breach of fiduciary duty has made a profit, it seems more likely than not that he or she will make a claim for an equitable allowance or a share in the profits. Therefore, whatever theoretical potential section 61 offers to afford relief to a trustee's breach of fiduciary duty, there is little to suggest that in the future the section will occupy any more than a token and residual role.[102]

## I SECTION 61: BACK TO THE FUTURE?

Left alone, section 61 may continue to lie dormant, rising only occasionally to rescue a lay trustee from liability for a technical but negligent breach of duty.

[100] Nor does it undermine the requirement that a fiduciary normally provide services gratuitously, see Nolan (above n 85) 117.

[101] See Elias J in *Nottingham University v Fishel* [2000] ILRL 471, 485; *Badfinger Music v Evans* 2000 WL 33148811; and Tipping J in *Estate Realties Ltd v Wignall* [1992] 2 NZLR 615, 630–31.

[102] For the view that s 61 "offers a viable but as yet unexploited base for a change of position defence which is general to trustees" see Elias (above n 91) 20.

This would find sympathy with its Victorian architects whose primary concern was not to jeopardise the supply of competent lay trustees by exposing them to liability for honest and reasonable breaches. However laudable, this objective can no longer claim to be of equal moment to the modern trust and trustee. As such, section 61 may come to deserve the same complacent plaudit that the DTI's Steering Group awarded section 727. It remarked that it was little used but still of value.[103] To be fair, the DTI proposes minor changes, including the deletion of the requirement of reasonableness from the section.[104]

Leaving the specific company law proposal to one side, there may be merit in canvassing whether the terms of the trust legislation needs updating. One view is that, at least in respect of investment activities, the need for such a reform may be redundant. Provided the courts are willing to apply the provision to a paid professional trustee, the modernising influence of the reforms in the Trustee Act 2000 may have incidentally reinvigorated section 61. For if it originally pivoted around a self-fulfilling synergy between the standard of care and its requirement of reasonableness, then it now has a renewed potential to do the same, only now by reference to the new trusts legislation. Turning to breaches of fiduciary duties, in principle there is nothing to preclude the judges applying section 61 to grant relief in such cases. However, as has been argued in this Chapter, in practice the courts are more likely to be asked to consider awarding an equitable allowance rather than statutory relief.

Although this is a viable vision of how section 61 might continue to have relevance to the modern trust and professional trustee, overall it does seem likely that the section will not be as prominent or prevalent a feature of trust litigation in the current century as it was in the first 50 or so years following the enactment of its predecessor in 1896. This is not to deny that re-drafting section 61 may be worthwhile. Reform may merely be an exercise in fine-tuning. A more radical option would be to alter the language of the section to provide the most open-ended of discretions, by which a court might grant relief "if it thinks fit." At the other extreme, lies the possibility of eradicating the inherently imprecise statutory discretion by framing some fixed standard.[105] However, before there is any recourse to re-drafting, thought needs to be given to the overall objective of the exercise, and its connection with other trust matters currently under review.

To many, the fate of section 61 is seen as peripheral to the more central business of determining the future of trustee exemption clauses.[106] In terms of the law reform agenda, exemption clauses may rightly overshadow section 61. It

[103] The Company Law Review Steering Group *Modern Company Law For a Competitive Economy: Developing the Framework* (DTI/Pub 4754/4k/3/00/NP. URN 00/656, 2000) paras 3.24–3.27.

[104] The Company Law Review Steering Group *Modern Company Law For a Competitive Economy: Final Report* (DTI/Pub 5552/5k/7/01/NP. URN 01/943, 2001) paras 6.2–6.4. Such a solution is in response to the current judicial attitude to s 727 (in the body of cases considered above n 79 and associated text) that it is hard to regard a director as having acted reasonably if he is liable in negligence.

[105] Mooted by the Trust Law Committee (n 49 above) para 6.3, although perhaps inevitably no indication is offered as how such a standard might be framed.

[106] Note 49 above.

would be unfortunate if the opportunity is not taken to see these interrelated matters holistically. As a first move in this direction it would be invaluable if the Law Commission were to undertake an appraisal of the continuing demand for and function of a statutory relieving provision.[107] This would ensure that any development of the law would prove itself worthy of the endeavours of those who framed the 1896 Act.

[107] This might involve a consideration of some of the related matters considered n 46 above and text thereto.

# 10

# *Consent*

JENNIFER PAYNE

## A INTRODUCTION

A VARIETY OF defences has always been available to trustees who act in breach of their trust obligations. Perhaps the longest standing defence is that which states that a beneficiary who consents to a breach of trust will have no claim against the trustee in relation to that breach. On occasion the consenting beneficiary may even have to indemnify the trustee.[1] This seems straightforward enough. Indeed in the more than 250 years since this principle was first enunciated there seems to have been remarkably little controversy surrounding it.[2] It applies not only to trustees but to other fiduciaries, in particular company directors. In the latter context, a recent case has raised a number of difficult issues concerning its application.

In *Knight v Frost*[3] Knight paid £300,000 in January 1989 to purchase shares in a company, ZUK. Frost was the majority shareholder and a de facto director of ZUK who "at all material times exercised all of the powers of the board."[4] £280,000 of Knight's money was immediately loaned by ZUK's directors to ZUS, a US corporation owned by Frost and his wife which was effectively insolvent and which owed substantial sums to Frost. Knight subsequently agreed to give ZUK's bank a limited guarantee for £45,000 in order to enable ZUK to lend a further £75,000 to ZUS. In breach of Frost's duty qua director to ZUK both of these loans were made without a commercial rate of interest being attached to them. Subsequently Knight gave a further guarantee to ZUK's bank, this time unlimited, in order to keep the company afloat.

Neither of the two loans was repaid. Knight sought to bring a derivative action on behalf of the company inter alia against Frost in relation to these payments. Hart J had no difficulty in holding that the dominant purpose of

[1] *Trafford v Boehm* (1746) 3 Atk 440; Trustee Act 1925, s 62.
[2] As Handley JA commented in *Spellson v George* (1992) NSWLR 666 when reviewing the English case law on this issue: "The reported cases in which the defence has been considered contain surprisingly little analysis of the defence or the manner in which it operates" (669).
[3] [1999] 1 BCLC 364.
[4] *Knight v Frost* (n 3 above) 368.

these loans was to benefit ZUS and that therefore Frost was in breach of his fiduciary duty to act bona fide in the best interests of ZUK in relation to these loans. In addition, since Frost was both director of ZUK and shareholder of ZUS he was in breach of the self-dealing rules in failing to comply with the requirements of section 317 Companies Act 1985. However, Frost argued that, despite these breaches, no derivative action could be brought by the shareholders of ZUK on behalf of the company because Knight had acquiesced in these breaches of duty. Hart J said:

> In my judgment the test to be applied in determining whether the plaintiff's acquiescence in what happened is sufficient to disentitle ZUK from now pursuing Mr Frost for breach of fiduciary duty is the same test as that applicable in the analogous case of the beneficiary's acquiescence in a breach of trust. That was expressed by Wilberforce J in *Re Pauling's Settlement Trusts* [1961] 3 All ER 713 at 730 . . .[5]

On the facts of this case, Hart J held that Knight had not acquiesced to the first loan since, although he knew that a substantial chunk of his £300,000 would be sent to ZUS and that the nature of the business in which he was investing was essentially speculative, Knight's "consent" had been established through misleading representations from Frost as to the financial substance of ZUS. However, in Hart J's view, Knight had consented to the subsequent loan of £75,000 since by that time Knight must have been aware of the financial substance situation of ZUS. Accordingly, although Hart J was prepared to allow ZUK's claim against Frost for recovery of the first loan, he was not prepared to allow a claim in relation to the second loan.

Of particular interest in *Knight v Frost* is the manner in which the principles of trust law are translated into company law, and the assumption by Hart J that breach of trust and breach of duty by a director are for this purpose "analogous." This chapter will investigate the application of the consent defence and suggest that the two situations are not as analogous as Hart J suggests. *Knight v Frost* gives rise to two interesting issues: did Knight actually consent to the breach by Frost and, if so, what is the effect of that consent?

## B CONSENT TO BREACH OF TRUST

As early as 1818 Lord Eldon restated the basic principle:

> It is established by all the cases, that if the cestui que trust joins with the trustees in that which is a breach of trust, knowing the circumstances, such a cestui que trust can never complain of such a breach of trust. I go further, and agree that either concurrence in the act, or acquiescence without original concurrence, will release the trustees: but that is only a general rule and the court must inquire into the circumstances which induced concurrence or acquiescence.[6]

[5] *Knight v Frost* (n 3 above) 375.
[6] *Walter v Symonds* (1818) 3 Swans 1, 64; 36 ER 751, 774. Cf *Trafford v Boehm* (1746) 3 Atk 440.

The modern formulation is generally stated in the words of Wilberforce J, as he then was, in *Re Pauling's Settlement Trusts*:[7]

> [T]he court has to consider all the circumstances in which the concurrence of the cestui que trust was given with a view to seeing whether it is fair and equitable that, having given his concurrence, he should afterwards turn round and sue the trustees: that, subject to this, it is not necessary that he should know that what he is concurring in is a breach of trust, provided that he fully understands what he is concurring in and that it is not necessary that he should himself have directly benefited by the breach of trust.[8]

This formulation of the consent defence is repeated by both courts[9] and commentators[10] with surprisingly little further discussion or analysis.[11] As Wilberforce J's statement makes clear, a vital element of this defence is that it should be fair and equitable to deny the beneficiary a subsequent claim against the trustee.[12] At a certain level of generality this must be correct, but the matter cannot be left at that level.

It is unarguable that an express *contractual* promise by the beneficiary to a trustee that he will not sue in relation to a particular future breach of trust will not be binding on the beneficiary since, in the absence of vitiating factors, contractual promises are always binding.[13] It seems equally clear that a promise made before a breach of trust should be upheld even if not binding as a contract if it would be unfair or inequitable to allow the beneficiary to renege on his promise. Such equitable considerations will arise from the fact that the trustee has placed himself in a position of potential liability, which he could otherwise have avoided, as a result of his reliance on the beneficiary's promise. If the trustee would not, or might not, have acted as he did, and brought about the breach of trust if the beneficiary had not undertaken to forego any claim then presumably it would be inequitable to allow the beneficiary to renege on that promise at a later date.

In addition to situations in which the consent is based upon a manifestation of an agreement of some kind by the beneficiary not to sue the trustee, there will also be situations in which the court will infer that agreement merely from a beneficiary's consent to the breach of trust itself. Even in the absence of anything resembling an agreement it seems no less unfair and inequitable to allow a beneficiary who has given an effective consent to, say, a disposition of assets

[7] [1961] 3 All ER 713.
[8] *Re Pauling's Settlement Trusts* (n 7 above) 730, specifically endorsed on appeal [1964] Ch 303 (CA) 338.
[9] Eg, *Spellson v George* (1992) NSWLR 666; *Knight v Frost* [1999] 1 BCLC 364.
[10] J Martin (ed) *Hanbury and Martin's Modern Equity* (16th edn Sweet and Maxwell London 2001) 663–664; P Pettit *Equity and the Law of Trusts'* (8th edn Sweet and Maxwell London 1997) 491; D Hayton (ed) *Underhill and Hayton's Law of Trusts and Trustees* (15th edn Butterworths London 1995) 894.
[11] Eg, *Spellson v George* (1992) NSWLR 666 (NSWCA) 669 (Handley JA).
[12] *Re Pauling* (n 7 above) 730.
[13] Generally: Sir Guenter Treitel *The Law of Contract* (10th edn Sweet and Maxwell London 2000) Ch 13.

in breach of trust to later be allowed to sue the trustee for that wrongful disposition.[14] Most of the cases in this area, including *Re Pauling* itself, actually involve this latter situation, that is an express consent to the act constituting a breach of trust. Any agreement not to sue is then merely an inference of law.

If the test applied by the court were merely one of fairness and equity, then it would, rightly, attract the same criticism as Lord Nicholls made of the notion of "unconscionability" as the touchstone of liability in the context of cases concerning assistance with breach of trust. Lord Nicholls stated that a test of unconscionability is meaningless unless it is made clear "what, *in this context*, unconscionable *means*."[15] Likewise we need some guidance as to what fairness and equity will mean in relation to consent to breach of trust in a particular fact situation. Some guidance is available. Indeed it is relatively easy to find a number of seemingly well-settled statements as to the content of the consent defence:[16]

(i) the consenting beneficiary must be of full age[17] and sound mind;
(ii) the consent must not have been obtained through undue influence;[18]
(iii) the fact that one beneficiary has consented to a breach will not affect the rights of other beneficiaries who have not done so;[19]
(iv) the beneficiary should fully understand "in what he concurred"[20] but need not know that it is a breach of trust which he is consenting to;
(v) it is not necessary that the beneficiary should have benefited from the breach;[21] and
(vi) all the circumstances must be taken into account in determining whether to allow the beneficiary a claim against the trustee.[22]

[14] When the consent defence is phrased in this way, as a situation in which it is unfair and inequitable to allow the beneficiary to sue the trustee because the beneficiary has led the trustee to believe that he or she will not sue either by express agreement not to sue, or by consent to the breach of trust itself on which the trustee has subsequently relied in carrying out the breach, then the basis of the defence can be accommodated within estoppel. Many cases rely on an estoppel rationale: *Swan v Perpetual Executors and Trustees Association of Australia Ltd* (1897) 23 VLR 293, 309 (Holroyd J); *Phillipson v Gatty* (1848) 7 Hare 516, 523 (Wigram V-C); *Chillingworth v Chambers* [1896] 1 Ch 685, 704 and 708; *Holder v Holder* [1968] Ch 353, 403 (Sachs LJ) Quite how far the consent defence can be regarded as estoppel-based is open to question. Certainly some instances of the consent defence are very close to the classic notion of estoppel based on some from of representation by one party to another on which the second relies to his or her detriment. However, it is clear that consent does not invariably operate through estoppel.

[15] *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (HL) 392 (his emphasis).

[16] This list is not intended to be exhaustive but does include the points generally accepted by commentators as forming the basis of the defence: references in n 10 above.

[17] *Lord Montfort v Lord Cadogen* (1810) 19 Ves 635; *Overton v Bannister* (1844) 3 Hare 503, 506 (Wigram V-C).

[18] *Farrant v Blanchford* (1863) 1 De GJ & Sm 107; *Stevens* v *Robertson* (1868) 18 LJ 427.

[19] *Brice v Stokes* (1805) 11 Ves 319; *Ghost v Waller* (1846) 9 Beav 497.

[20] *Re Pauling* [1961] 3 All ER 713, 730 (Wilberforce J).

[21] *Chillingworth v Chambers* [1896] 1 Ch 685; *Fletcher v Collis* [1905] 2 Ch 24.

[22] *Re Pauling* [1961] 3 All ER 713, 730 (Wilberforce J).

These statements are generally presented as being of application to *all* instances of consent to breach of trust.[23] However, "consent" to breach of trust is not a single, simple concept to which a single, simple set of rules can necessarily be applied in order to determine whether the beneficiary should be allowed to sue the trustee.[24] Rather, it includes a number of distinct fact situations, ranging from a beneficiary who expressly agrees not to sue the trustee before the breach occurs to a beneficiary who discovers the breach only after it occurs and does nothing indicating either agreement or objection to the breach, with numerous permutations in between.[25] Overarching all of these fact situations is, of course, the need for it to be fair and equitable for the beneficiary to be denied a claim. Therefore it seems that these statements (i)–(vi) set out above can be of universal application only so far as they reflect the requirements of fairness and equity in any given situation.

Statements (i)–(iii) seem unexceptionable on this basis. It is difficult to imagine any fact situations in which it could be fair and equitable to deny the beneficiary a claim merely on the basis of the consent of one of his fellow beneficiaries, or if that consent was induced by undue influence, or if the beneficiary lacked the necessary capacity to consent.[26]

Statement (v) requires a little more thought. It is possible to envisage instances in which the court should take account of the fact that the beneficiary has benefited from the breach. In *Stafford v Stafford*,[27] for example, a woman was informed of an impending breach of trust and said nothing. She accepted payments flowing from that breach of trust for the next 15 years and during that time she did nothing to assert her right to sue the trustees for the breach. At the end of this period she then decided to bring a claim against the trustees in relation to this breach. Her claim failed.

Instances of consent inferred merely from a failure of the beneficiary to bring a claim over a period of time are rare. This is perhaps not surprising. It is difficult to see how it should generally be fair and equitable to throw the onus of

[23] Lord Hailsham of St Marylebone *Halsbury's Laws of England* (4th edn Butterworths London 1973– ) vol 48 (2000 reissue) paras 1014–1015. Some commentators accept that there are differences to be drawn between, for example, concurrence and acquiescence, but nevertheless suggest that the statements (i)-(vi) apply in all cases: J Martin (n 10 above) 663 et seq, esp 666 regarding statement (iv).

[24] The process of disentangling the various fact situations which fall within the umbrella of the term "consent" is not helped by the fact that the courts and commentators use different phrases without defining exactly what they mean in each case. For instance, Lord Eldon in *Walker v Symonds* (1818) 3 Swan 1, 64 talks variously of "concurrence", of acts "authorized" or "adopted" by the beneficiary and of "acquiescence". See also Wigram V-C in *Phillipson v Gatty* (1848) 7 Hare 516, 523. Other judges have spoken of "inducement" or "assent" by the beneficiary: *De Bussche v Alt* (1878) 8 Ch D 286, 314 (James, Baggallay and Thesiger LJJ), of "release of the trustees," of "estoppel by words or conduct" and of acts "sanctioned" by the beneficiary: *Life Association of Scotland v Siddal* (1861) 3 De G F & J 58, 73–4; 45 ER 800, 806 (Turner LJ).

[25] See, for example, *Spellson v George* (1992) NSWLR 666 (NSWCA) 679 (Young JA).

[26] Of course, the court will still have to determine the meaning of concepts such as undue influence and "necessary" capacity. This discussion falls outside the ambit of this chapter.

[27] (1857) 1 De G & J 193.

objecting to a breach of trust onto the beneficiary in this way. As Turner LJ has said:

It is the duty of the trustee to observe the trust . . . and I am not prepared to hold that he can be permitted to escape from the liability incident to that duty by simply informing the *cestui que trust*—that he . . . intends to commit a breach of it. He cannot . . . throw upon the *cestui que trust* the obligation of telling him what his duty is, and of cautioning him to observe it.[28]

Mere inaction over a long period of time of the kind seen in *Stafford v Stafford* should generally not lead to an implication of consent on the part of the beneficiary.[29] Something exceptional is required if it is to be fair and equitable to deny the beneficiary a claim for breach of trust as a result of inaction. The fact that the beneficiary in *Stafford* had benefited was sufficiently exceptional to render her inactivity an effective consent. It was therefore desirable for the court to take her benefit into account in that case. The accepted formulation of statement (v),[30] that it is not *necessary* that the beneficiary has benefited, should not prevent the court from taking account of benefit in rare cases like *Stafford*.

Statement (iv), regarding the requisite knowledge of the beneficiary, and specifically whether he or she was aware that what was being consented to was a breach of trust, is more problematic. In particular the interaction of this statement with that in (vi), which requires all the facts to be weighed, needs to be carefully considered. The case of *Re Pauling* is central to an understanding of this interaction.

In *Re Pauling* the trustees of a marriage settlement, a bank, were empowered with the written consent of W, the life interest holder, to exercise the power of advancement in relation to up to 50 per cent of the vested share of each of the four children of the marriage and "to pay the same . . . for his or her advancement or otherwise for his or her benefit in such manner as the trustees shall

[28] *Life Association of Scotland v Siddal* (1861) 3 De GF & J 58, 73–4, 45 ER 800, 806. Although this is clearly meant in the context of reversionary interests, it is difficult to see why it should not apply more widely, to all beneficial interests.

[29] This should now be left to the Limitation Act 1980. Although some early cases did suggest that a beneficiary can be disentitled from relief by mere acquiescence over a long period of time—*Life Association of Scotland v Siddal* (1861) 3 De GF & J 58, 77 (Lord Campbell LC)—the better view is stated clearly by Wilberforce J in *Re Pauling* [1961] 3 All ER 713 in relation to what was then the Limitation Act 1939: "[t]here being an express statutory provision providing a period of limitation for the plaintiffs' claims, there is no room for the equitable doctrine of lache." (735) aff'd in *Re Pauling* [1964] Ch 303 (CA) 353. An example of the modern approach to this issue can be seen in *John v James* [1991] FSR 397, 438 (Nicholls J). The only exception to this is if the Limitation Acts do not apply for any reason. For example, s 21(3) Limitation Act 1980 provides that in relation to a beneficiary with a future interest, the limitation period under the Act does not start to run until the interest is in possession. In relation to a beneficiary with a future interest who learns of a breach of trust and effectively consents to it, for example by acquiescence, for 20 years before coming into possession, there may be some argument that at that point it may be unconscionable to allow the beneficiary to sue the trustee for the breach.

[30] *Chillingworth v Chambers* [1896] 1 Ch 685; *Fletcher v Collis* [1905] 2 Ch 24; *Re Pauling* [1961] 3 All ER 713, 730 (Wilberforce J).

think fit." The family constantly lived beyond its means. Some 34 advancements were made in total. Some were made for the children's benefit and were not in breach of trust, but others were clearly made for the benefit of W and were regarded by the court as breaches. However, on each of these latter occasions the children in question had signed letters of consent to the breaches prior to them occurring. Some of these purported consents were discounted, as having been uninformed and "blindly-given."[31] However, where the consent was valid this had the effect of precluding those beneficiaries that had consented from making the bank liable for the breach in question. When faced with the question of the appropriate test of knowledge for these beneficiaries Wilberforce J reviewed the authorities and produced the test which he felt he should apply. This test bears repetition:

> [T]he court has to consider all the circumstances in which the concurrence of the cestui que trust was given with a view to seeing whether it is fair and equitable that, having given his concurrence, he should afterwards turn round and sue the trustees: that, subject to this, it is not necessary that he should know that what he is concurring in is a breach of trust, provided that he fully understands what he is concurring in and that it is not necessary that he should himself have directly benefited by the breach of trust.[32]

This test therefore contains both statement (iv) and statement (vi). It is clear that Wilberforce J intended both statements to be relevant in *Re Pauling*. But should both be regarded as universally applicable tests in cases of consent to breach of trust? It is arguable that, considering all the circumstances of *Re Pauling* itself, it was fair and equitable for Wilberforce J to deny the beneficiaries' claims in that case even though they did not know that what they were consenting to amounted to a breach of trust. Wilberforce J stressed that the two beneficiaries in question were educated men, perfectly capable of appreciating the terms of the trust and their importance and, indeed, in relation to at least one of the two Wilberforce J seems to suggest that he may well have known both of his beneficial interest and of the breach of trust in any case.[33] However, it is questionable whether Wilberforce J's *specific* proposition, that the beneficiary need not appreciate the legal consequences of his consent, was intended to mean more than that it is not always fatal to a defence of consent that the beneficiary lacked that knowledge.[34]

It is better to regard Wilberforce J as setting down a general approach to the elements of an effective consent, requiring that they be weighted in the light of all the circumstances of the case, and to view his decision as holding that on the totality of those particular facts specific knowledge of the legal nature of what was being done was not a precondition of an effective consent. To regard his

[31] [1961] 3 All ER 713, 734.
[32] [1961] 3 All ER 713, 730.
[33] *Re Pauling's Settlement Trusts* (n 32 above) 730–731.
[34] Support for this view can be found in *Spellson v George* (1992) NSWLR 666 (NSWCA) 676 (Hope AJA obiter).

specific knowledge test as a universal test is, on this analysis, a mistake. However, there does seem to be some confusion as to the status of Wilberforce J's specific knowledge test in *Re Pauling*. For instance, the formulation of the consent defence contained in Halsbury seems much less flexible:

> Where a beneficiary sues in respect of a breach of trust, then, if his consent or concurrence is relied on as a defence to his proceedings, the court has to consider all the circumstances with a view to deciding whether it is fair and equitable that he should sue the trustees; but it is not necessary for the purpose of protecting them that the beneficiary should have known that it was a breach of trust in which he concurred, if he fully understood in what he concurred, nor is it necessary that he himself should have benefited from the breach There is no hard and fast rule that ignorance of a legal right prevents an effective consent being given, but all the circumstances must be looked at to see whether it is just that the complaining beneficiary should succeed against the trustee.[35]

Perhaps it is not surprising, then, that Hart J in *Knight v Frost*[36] applies Wilberforce J's specific knowledge test as though it were a universal test. Although Hart J does not expressly refer to the test of knowledge which he is applying to Knight in order to determine whether his consent to the loan of £75,000 will bar his claim, he does, of course, refer to the relevant passage in *Re Pauling* which contains the test. That he must have applied Wilberforce J's test of knowledge is clear on an analysis of the facts and the outcome in that case. While it may be argued that Knight understood the general circumstances surrounding the guarantees he gave, and the fact that these guarantees enabled loans to be made to ZUS, so that he can be said to have fully understood the circumstances surrounding his consent, it is difficult to see how Knight can be said to have had knowledge that what he was consenting to amounted to a breach of duty by Frost.

It seems clear that Knight would almost certainly not have known of the dire financial straits of ZUS until 1990 during which Knight was provided with a copy of the unaudited accounts of ZUS for the year ended 31 January 1990 and with a copy of a "management report" submitted by Frost to the bank in autumn 1990 at which point it "must have been clear to [Knight] . . . that neither ZUK or ZUS had any money."[37] Of course, after that date (and, importantly, after the date of the breach of duty) Knight went on to give an unlimited guarantee, but the *limited* guarantee on which Hart J relies as evidence of Knight's consent occurs in 1989, *before* Knight was in possession of this information. Without this information at the time of his consent it is difficult to see how Knight can have appreciated that the loans would constitute a breach of duty by Frost. If Hart J had taken this issue into account then he would surely have

[35] Halsbury (n 23 above) vol 48 para 1015. Note that this test is not limited to instances of "concurrence" but is intended to apply, in addition, to consent more generally. As a minimum this seems to include instances of acquiescence, if not release, which seems to be dealt with separately at para 1016.

[36] [1999] 1 BCLC 364.

[37] [1999] 1 BCLC 364, 371.

found that Knight did not consent. However, Hart J concluded that, on the facts, Knight did consent to Frost's breach of duty in relation to the second loan of £75,000 from ZUK to ZUS.[38]

The preferable view is not to regard Wilberforce J's specific knowledge test as a universal test but instead to concentrate on the general principle which he sets down in *Re Pauling*, ie, to take all the facts into account when determining whether the beneficiary should be denied a remedy. This could well mean that in a given fact situation it will only be fair and equitable to deny the beneficiary a claim against the trustee if the beneficiary did appreciate the legal consequences of his or her consent. There is support for this view.

It is clear that Wilberforce J did not regard the test which he was laying down as all-encompassing. He limits his test to cases of "concurrence." The courts have never adopted clear definitions of the words which they variously use to describe different kinds of consent, but the use of the word "concurrence" tends to designate consent to the breach via positive acts of the beneficiary,[39] as opposed to consent through inaction ("acquiescence").[40] It also seems to exclude cases where the beneficiary releases the trustee from liability after the breach has occurred.[41] This obviously fits with *Re Pauling* which concerned positive acts of the beneficiaries which amounted to consents to the breaches of trust. It also fits the fact that in *Re Pauling* Wilberforce J relied heavily on the earlier case of *Evans v Benyon*,[42] another case involving

[38] [1999] 1 BCLC 364, 378. It is not disputed that Hart J was right to allow the derivative action in relation to the first loan of £280,000.

[39] This can include positive acts of the beneficiary which either amount to a consent to the breach or to an agreement not to sue and can also include instances of instigation of the breach by the beneficiary: *Evans v Benyon* (1887) 37 Ch D. 329; P Pettit *Equity and the Law of Trusts* (8th edn Butterworths London 1997) 491.

[40] Inaction here really means a failure on the part of the beneficiary to bring an action in relation to a breach of trust, but this can be coupled with other activity which may suggest that the beneficiary accepts the breach without expressly saying so: *Holder v Holder* [1968] Ch 353 (CA).

[41] Although this situation tends to be included as an instance of consent by most commentators, eg, Halsbury (n 23 above) (4th edn 2000 reissue) vol 48 paras 1014–1015; Hanbury and Martin (n 10 above) 663; P Pettit (n 39 above) 49, it is in fact probably best regarded as a situation in which the beneficiary's consent will not be upheld unless that consent forms part of a binding contract between the trustee and the beneficiary which can then be enforced by the trustee in contract. In the absence of such a contract it is difficult to see why it should be equitable to hold a beneficiary to a post-breach release as the element of reliance on the part of the trustee will be lacking. This has never been made explicit by the courts but it is submitted that the reasoning of the courts in this area can provide some support for this view. In particular, the courts have held that a release following a breach has often been said to require some element of valuable consideration, however slight, to be given on the part of the beneficiary: *Stackhouse v Barnston* (1805) 10 Ves 453; *Ghost v Waller* (1846) 9 Beav 497. Only the old case of *Egg v Devey* (1847) 10 Beav 444 seems to contradict this view. This is not an altogether straightforward case, however, as it involved the plaintiff being left money in a will, the acceptance of which was said to preclude the plaintiff from bringing a subsequent breach of trust claim. Although the gift under the will in this case could be regarded as separate from the trust, the court clearly regarded the two as being linked and placed a lot of emphasis on the receipt and acceptance by the plaintiff of the gift under the will in holding that the plaintiff had given up the right to bring a breach of trust action. It is therefore suggested that it would be a mistake to place too much reliance on this case.

[42] (1887) 37 ChD 329 (CA).

concurrence,[43] when establishing that the beneficiary need not have knowledge of the breach of trust.[44]

Further support for the view that Wilberforce J's specific knowledge test should not be regarded as a universal test can be found in the case of *Holder v Holder*.[45] In that case the defendant had acted in breach of trust by purchasing trust property. He, like the plaintiff, had mistakenly assumed that he had successfully renounced his trusteeship. The defendant argued that the plaintiff had consented to the breach of trust because, rather than attempting to rescind this sale he had pressed for the defendant to lose his deposit when the defendant looked unlikely to be able to complete. This then was a case of acquiescence since the defendant was claiming that the plaintiff had done nothing to assert his claim against the trustee, from which the plaintiff's consent to the breach could, according to the defendant, be implied. The plaintiff argued that since he had not appreciated that the defendant was a trustee, he had not known that the sale amounted to a breach of trust. He was therefore unaware of his right to rescind.

The question for Cross J at first instance was whether this lack of knowledge should be taken into account in determining whether to allow the plaintiff a claim for breach of trust. Cross J reviewed the authorities on this point. He referred to Wilberforce J's conclusion "on the analogous question of what degree of knowledge the beneficiary must have in order to be held to have concurred in a breach of trust"[46] and immediately went on to express his own opinions on the issue of whether he should apply the same test:

> Equally, in my judgment, in cases of alleged acquiescence one cannot lay down a hard and fast rule to the effect that knowledge of the legal consequences of known facts is or

[43] A note of caution is necessary. Although *Evans v Benyon* was a case involving a positive act by the beneficiary which amounted to a consent to the breach, as in *Re Paulings*, in *Evans* there is an important difference because in that case the breach was instigated by the beneficiary. Arguably the comments regarding knowledge in *Evans v Benyon* are limited to a beneficiary who "consents to and is active in the distribution of" the trust fund (344 Cotton LJ). Instigation of the breach by the beneficiary has long been recognised by both parliament and the courts as being different to a simple consent by the beneficiary to the breach, and as having more serious consequences attached to it, especially regarding the possible indemnification of the trustee by the beneficiary. Trustee Act 1925 s 62, which deals with the circumstances in which a beneficiary may be required to indemnify a trustee, draws a distinction between an express consent by a beneficiary, which must be in writing, and the situation in which the beneficiary instigates the breach, in which case no writing is required. At common law a different distinction is drawn regarding the availability of indemnification for the trustee in these two different situations. As regards express consent, indemnification will only occur if the beneficiary has obtained a personal benefit: *Booth v Booth* (1838) 1 Beav 125; *Chillingworth v Chambers* [1896] 1 Ch 685. However, if the beneficiary instigates the breach then no personal benefit need be shown: *Sawyer v Sawyer* (1885) 28 ChD 595. Therefore, it is arguable that Wilberforce J in *Re Pauling* should not have applied the test of the beneficiary's knowledge utilized in *Evans v Benyon* beyond the narrow confines of that case.

[44] The fact that Wilberforce J limited his test to cases of concurrence also helps to explain a number of cases prior to *Re Pauling* which had adopted different tests of knowledge and which Wilberforce J seemingly felt no need to distinguish, eg, *Farrant v Blanchford* (1863) 1 De GJ & Sm 107, esp 119 (Lord Westbury).

[45] [1968] Ch 353 (CA).

[46] *Holder v Holder* (n 45 above) 369.

is not essential to the success of the plea. It all depends on the circumstances. On the facts in *Stafford v Stafford*[47] one can well see why the Lords Justices thought that it would be unjust to allow the petitioner to rely on her ignorance of her rights. However, in this case . . . it would, to my mind, be altogether unjust to impute to him knowledge of the legal consequences . . . of the facts which he did know.[48]

The "equally" at the start of that quotation is important. Cross J felt himself in agreement with the statement of Wilberforce J in *Re Pauling*. Since he applies a different specific test of knowledge to the facts before him, he can only be agreeing with the general principle stated by Wilberforce J in that case regarding the need to take all of the facts of the case into account when determining the question of the beneficiary's knowledge. Cross J is clearly of the view that the specific knowledge set out by Wilberforce J is not a universal test. The Court of Appeal agreed.[49] Harman LJ said:

Like the judge, I should desire to follow the conclusion of Wilberforce J who reviewed the authorities in *In re Pauling's Settlement Trusts*[50]. . .There is therefore no hard and fast rule that ignorance of a legal right is a bar, but the whole of the circumstances must be looked at to see whether it is just that the complaining beneficiary should succeed against the trustee.[51]

It seems that Wilberforce J's specific test of knowledge should not be regarded as a universal test. However, a narrow or a wide view can be taken as to precisely when his specific test should be applied. The narrow view is that the test, while not universal, is nevertheless intended to cover all acts which are regarded as comprising "concurrence," ie, situations in which the beneficiary instigates the breach, expressly consents to the breach occurring, or expressly agrees not to sue the trustee before the breach occurs. The wide view, which finds some support in the decision of the Court of Appeal in *Holder,* is that the specific test should not apply automatically even in cases of concurrence and that even in these cases the court should always determine the appropriate test of knowledge by having regard to the particular circumstances before them.

This latter view is preferable because the overarching interests of fairness and equity may mean than even though the beneficiary has prima facie consented to the breach, or even instigated it, it may only be fair and equitable on the particular facts of a case to deny them a subsequent claim if they knew of the fact that they were consenting to (or instigating) a breach of trust. Take, for example, the situation in which a beneficiary requests the trustees to make certain investments which turn out to be in breach of trust. The beneficiary is not aware

47 (1857) 1 De G & J 193.
48 *Holder v Holder* (n 45 above) 369–70 (Cross J).
49 [1968] Ch 353.
50 [1962] 1 WLR 86; [1961] 3 All ER 713.
51 [1968] Ch 353, 394. However, the Court of Appeal reversed Cross J's application of this test to the facts of the case, finding that the plaintiff should not be able to claim breach of trust because he had, with full knowledge of the facts (albeit ignorance of the breach of trust) affirmed the sale and accepted part of the purchase price.

that the suggested investments amount to a breach of trust and reasonably assumes that the trustees will check this point and only carry out the investment if it is in fact within the terms of the trust instrument. In such a situation should the beneficiary's instigation be regarded as an effective consent? It could be argued that it would not be fair and equitable to deny the beneficiary a subsequent claim.

A resolution of these two views is not, however, necessary in order to deal with the decision in *Knight v Frost* because even on the narrow view Hart J was mistaken to treat the specific knowledge test in *Re Pauling* as automatically applicable to the facts of that case. Knight's consent, if it exists, does not fall within the category of concurrence. Knight does not instigate the breach, nor does he consent to it directly, nor does he specifically agree not to sue Frost for the breach. Rather it is Knight's action in giving the limited guarantee, thereby assenting to the borrowing from the bank, on which Hart J relies in determining the existence of consent:

> In assenting to the borrowing (and by implication the on-lending) the plaintiff was making a sufficiently informed decision to disentitle him from now causing ZUK to complain of it."[52]

This could be analysed as consent by implication or, more likely, consent through acquiescence in the mould of *Holder v Holder*.[53] We must therefore look at all the circumstances in order to determine whether Knight should be allowed to bring an action against Frost. A good starting point seems to be the statement of Cross J in *Holder,* that in cases of acquiescence the beneficiary ought to know of his legal rights before it is fair and equitable to be denied a subsequent claim. There do not seem to be any good reasons for applying a different test to Knight's acquiescence.[54] The only thing which Knight does is to agree to money being borrowed which is subsequently on-lent by Frost to ZUS in breach of duty. Knight's ignorance that the loan to ZUS would involve a breach of duty seems crucial. In these circumstances it is difficult to see why it should be fair and equitable to deny Knight a claim against Frost on the company's behalf. On this basis it seems wrong for Hart J to have regarded Knight's actions as constituting an effective consent.

## C THE EXTENSION OF THE DEFENCE TO COMPANY LAW

In this part we turn from the requirements for an effective consent to the effects themselves. One important question is whether the effects are the same in the

[52] *Knight v Frost* (n 3 above) 378.
[53] Hart J refers to Knight's "acquiescence" throughout his judgment.
[54] For example, there is no element of personal benefit to Knight here. This was an issue which seemed crucial to the Court of Appeal in *Holder* in convincing them to depart from Cross J's application of the general principle to the facts of that case.

case of a director as in that of the trustee. Hart J regards the two as "analogous" so that the principle of consent to breach of trust can be utilised in relation to a situation such as that in *Knight v Frost* with no further thought to the particular company law aspects of the situation. This part will seek to show that the situations are not as analogous as Hart J suggests. Some caution is required when applying the consent defence in a company law context.

In company law a purported consent by a shareholder such as Knight can have relevance in two contexts: in actions by a shareholder against the company in relation to a duty owed to that shareholder personally and in actions by the company against someone else, such as a director, which the shareholder is bringing on the company's behalf. Some confusion arises at times because the same action can simultaneously give rise to both situations, so that, for example, a breach of the articles of a company may simultaneously involve a wrong done to the shareholders personally by the company (since section 14 Companies Act 1985 provides that the articles form a contract between the shareholders and the company) and a wrong done to the company by the directors who have caused it to act in breach of its articles.

## 1 Consent by Shareholders in Relation to a Duty Owed to them Personally

In relation to an action by the shareholder in relation to a wrong done to him personally, the trust principles of consent have obvious relevance. At heart, the *operation* of the concept of consent to breach of trust is a simple one. The difficulties which are referred to above relate to a determination of whether an effective consent has been given. Once an effective consent is located the operation of such consent is reasonably clear. An effective consent means that the beneficiary will lose the right to bring a claim against the trustee in relation to the breach, although clearly other beneficiaries who have not consented will retain this right.[55] The concept operates in this way because all of the trustees' duties are owed to the beneficiaries. They are the right individuals to bring an action against the trustees for breach of trust and therefore they are the right individuals to release the trustees. Since the right of release is personal, each beneficiary need only consider his or her own wishes when determining whether or not he or she will grant a personal release to the trustees: the beneficiary has no obligation to consider anyone else's interests in making this decision.

The beneficiary is therefore the right individual to agree not to sue in relation to a breach of that duty, either expressly or by consenting to the breach itself in some way, such as by acquiescing in the wrongdoing. Because of the personal nature of the right the consent of one beneficiary will not bind another. This fits very well with the situation in which the shareholder is owed a duty in his or her personal capacity.

[55] *Brice v Stokes* (1805) 11 Ves 319; *Ghost v Waller* (1846) 9 Beav 497.

One case regularly cited in this context, *Towers v African Tug Co*,[56] is worth examination. In that case the directors illegally but honestly applied a profit made in 1900 in payment of an interim dividend instead of in reduction of a debit balance. The balance sheet showing these mistakes was submitted to and approved by the shareholders. When they realised their mistake they proposed applying future profits to wipe out the debit balance, and this was accomplished in the following two financial years, as appeared from the balance sheets for those years, which were also submitted to and approved by the shareholders of the company. In 1903 two shareholders who had received their share of the dividend and had concurred in passing all three balance sheets commenced an action against the company on behalf of themselves and other shareholders of the company in relation to this ultra vires and therefore, at that time, unlawful[57] action by the directors acting on the company's behalf. The Court of Appeal unanimously held that in such circumstances the plaintiffs' action could not succeed:

> I think that an action cannot be brought by an individual shareholder complaining of an act which is ultra vires if he himself has in his pocket at the time he brings the action some of the proceeds of that very ultra vires act. Nor, in my opinion, does it alter matters that he represents himself as suing on behalf of himself and others.[58]

In fact, the shareholders in *Towers* were suing on behalf of the company in what would, subsequent to *Wallersteiner v Moir (No. 2)*,[59] be described as a derivative action but which was then described, confusingly, as shareholders "suing on behalf of [themselves] and all other shareholders against the company as defendants."[60] *Towers* has had implications for the derivative action as a result of this confusion between the personal and the derivative claim, an issue which will be discussed in more detail in the next section. However, for these purposes, it is clear that, rightly or wrongly, the Court of Appeal in *Towers* regarded the claims of the shareholders on behalf of the company as being an *aggregation* of the personal claims of the shareholders. The Court of Appeal were clear that these individual shareholders could not complain and could not

[56] [1904] 1 Ch 558.

[57] Cf Companies Act 1985 s 35.

[58] [1904] 1 Ch 558 (CA) 567 (Vaughan Williams LJ).

[59] [1975] QB 373 (CA) 391. Not only did the Court of Appeal in *Wallersteiner v Moir (No 2)* adopt the term "derivative action" to describe actions brought by minority shareholders on the company's behalf, but, in addition, this change of terminology helped to clarify the fact that in these circumstances the individual shareholder is not enforcing a personal right at all. This obviously has important consequences, so that, for example, shareholders can bring derivative actions in relation to wrongs which were done to the company before they became members (see eg, *Seaton v Grant* (1867) LR 2 Ch App 459), something which would obviously not be possible in relation to a personal action.

[60] [1904] 1 Ch 558 (CA) 571 (Cozens-Hardy LJ). At the time that *Towers* was decided, the term "representative action" was regularly used to describe both actions by shareholders on behalf of themselves (and maybe other shareholders) for wrongs done to them personally and actions by shareholders on behalf of the company for wrongs done to the company, see eg, *Foss v Harbottle* (1861) 2 Hare 461, 491–492 (Sir James Wigram V-C).

get any greater right of complaint because their action was, in form, an action by themselves and all the other shareholders in the company.[61]

It was therefore crucial to the application of the concept of consent in *Towers* that the court treated the shareholders' claim as though it were an action in consequence of their personal interest in the matter. In those circumstances the fact that the plaintiffs had acquiesced in the wrongful dividend payment in full knowledge of the facts, and indeed with their share of the dividend in their pockets, meant that it would have been inequitable for them to have been allowed to succeed in their claim on their own behalfs. Understood in this way the statements of the Court of Appeal that the personal interests and actions of the shareholders can bar their personal claims (whether individual or aggregated) are clearly correct. However, post-*Wallersteiner*, when the distinction between personal and derivative actions is well understood,[62] any wider application of the principle set out in *Towers* must be open to question.

## 2 Consent by Shareholders in Relation to a Duty Owed to the Company

### *(a) General Principles*

In *Knight v Frost* the action brought by Knight is not an action on his own behalf but an action on behalf of the company. The application of the trust concept of consent does not fit so well in this context. The reason for this is the involvement of three important company law principles: the separate legal personality of the company, [63] the concept of majority control, and the idea that a shareholder's vote is a piece of property so that "every shareholder has a perfect right to vote upon any such question, although he may have a personal interest in the subject matter opposed to, or different from, the general or particular interests of the company."[64]

Applying these principles to *Knight v Frost* makes it clear how problematic the translation of trust principles to company law in this context can be. Obviously Frost owes his duties as a director to the company, not to individual shareholders such as Knight.[65] This case does not revolve around any personal rights which might have existed between Frost and Knight and which might give rise to a claim by Knight in his personal capacity. The only relevant wrong in this case was a wrong done by Frost, qua director, to the company. Equally, the company, a legal person but not a natural person, cannot act for itself either in enforcing

[61] *Towers v African Tug Co* (n 56 above) 572 (Cozens-Hardy LJ).
[62] *Prudential Assurance Co Ltd v Newman Industries (No 2)* [1982] Ch 204; *Johnson v Gore Wood & Co* [2001] 2 WLR 72 (HL).
[63] *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL).
[64] *North-West Transportation v Beatty* (1887) 12 App Cas 589 (PC), 593 (Sir Richard Baggallay).
[65] *Percival v Wright* [1902] 2 Ch 421, unless the directors have acted in such a way as to put themselves into the situation of owing duties direct to the shareholders: *Briess v Woolley* [1954] AC 333 (HL); *Coleman v Myers* [1977] 2 NZLR 225; *Peskin v Anderson* [2001] 1 BCLC 372.

or forgiving this wrong. Enforcement would normally be by the board initiating an action against the wrongdoers. However, Frost is in control of the board and therefore no action against Frost is initiated by the board on the company's behalf.

Forgiveness of the wrong is governed by the company law concept of ratification. In fact, in company law the word "ratification" often masks two separate functions. For example, where a director negotiates a contract, but acts beyond the scope of his authority in doing so, any "ratifying" action by the shareholders will generally address two issues: the director's breach of duty and the validity of the contract. This is a distinction which is increasingly being drawn by academics[66] and has been drawn by parliament in some circumstances.[67] But it is probably fair to say that this distinction is not yet drawn in practice and a ratifying ordinary resolution of the shareholders will generally be assumed to have both effects where both effects are in issue.[68] However, in *Knight v Frost* only the effect of Knight's purported consent on Frost's obligation to compensate the company for losses caused by his breach of duty was in issue. There was no interest in whether this had any effect on the validity of the contracts themselves, and therefore the trust concept of consent can be compared exactly with its company law counterpart in this case.

Forgiveness of directors' breaches of duties to the company through ratification generally occurs by way of the shareholders in general meeting passing an ordinary resolution.[69] The effect of a valid ratification is generally accepted to be equivalent to a binding agreement on the part of the company not to sue the directors in relation to that breach. The fundamental principle by which such decisions in a company are taken is majority rule. This means that:

> [u]nless some provision to the contrary is to be found in the charter or other instrument by which the company is incorporated, the resolution of the shareholders, duly convened, upon any question with which the company is legally competent to deal, is binding upon the minority, and consequently upon the company.[70]

[66] See eg, RJ Partridge "Ratification and the release of directors from personal liability" [1987] CLJ 122.

[67] Eg, Companies Act 1985 s 35.

[68] By comparison the trust concept of consent to breach of trust equates only with the idea of the release of the directors from their personal liability, not any validation of a wrongful act. Unlike a company, a trust obviously has no legal personality separate to its trustees. When third parties enter into contracts with the trustees (the legal owners) they are not concerned with whether the trustees' acts "bind the trust" in any way. The contract will bind the trustees as individuals, whether they act rightfully or wrongfully in relation to the trust. The issue of "validation" of the contract therefore does not arise for either the third party outsiders or, indeed, the beneficiaries. Instead, the issue for the beneficiaries is whether to release the trustees from their personal liability for their wrongful acts and, further, whether the trustee has any rights of indemnity in relation to the breach.

[69] *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378 (HL). Cf where the company is insolvent or on the verge of insolvency, in which case it has been suggested that the interests of the creditors will intervene and the shareholders are not then the correct medium of ratification: eg, *West Mercia Safetywear v Dodd* [1988] BCLC 250.

[70] *North-West Transportation Co Ltd v Beatty* (n 64 above) 593 (Sir Richard Baggallay).

The situation can, of course, be contrasted with the trust situation in which each beneficiary can only bind him or herself when giving a release to the trustees. Each person to whom a duty is owed has a personal right to release the wrongdoer from that duty. To be free from doubt a trustee therefore needs to obtain the unanimous consent of all the relevant beneficiaries.

In addition, on the basis of the principle of a vote as a piece of property, a shareholder may release himself qua director, and he may generally do so even if he is a controlling shareholder of the company.[71] Of course, the beneficiaries of a trust can also utilise the decision of whether or not to release the trustees as they see fit, without any need to refer to the interests of anyone else. In that way their decision to release is as much a right of property as a shareholders' right to vote. However, crucially, a beneficiary can only bind him or herself with the decision whether to release the trustees. The beneficiary's decision will not bind anyone else, whereas the principle of majority control means that a shareholder, acting in its own self-interest, in exercising its right to vote, can affect other shareholders and, ultimately, the company.

Putting these principles together it is clear that Frost, as majority shareholder, can prima facie act in his own self-interest in using his votes to forgive the wrong he has done to the company. In a way which is impossible in relation to trusts, since the sole trustee cannot also be a sole beneficiary, wrongdoers such as Frost may be given the opportunity to use their shares to validate their own wrongdoing to a third party (the company).[72] Therefore the translation of the trust concept of consent to breach of trust into company law means that generally actions of a majority of the shareholders acting in their own best interests can be regarded as an act of the company and effectively operate as a consent to the director's breach of duty.[73]

This is the general rule in company law where the duty breached is owed to the company and not to the shareholders personally. However, *Knight v Frost* does falls within one of the exceptions to this general rule.[74] In limited circumstances the courts recognize the difficulties inherent in allowing a majority shareholder such as Frost effectively to forgive his own wrongdoing and in such circumstances they allow minority shareholders such as Knight to bring an action on behalf of the company.[75] The exceptional circumstances in *Knight v Frost*, Frost's control of the company and the potential for fraud to be practised on the company, therefore allow a derivative action to be brought.

[71] Subject to the small category of wrongs which are regarded by the courts as being unratifiable eg, *Cook v Deeks* [1916] 1 AC 554 (PC).
[72] *North-West Transportation Co Ltd v Beatty* (n 64 above).
[73] *Foss v Harbottle* (1843) 2 Hare 461.
[74] See, generally, *Edwards v Halliwell* [1950] 2 All ER 1064.
[75] See eg, *Smith v Croft (No. 2)* [1988] Ch 114; *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1981] Ch 257 and [1982] Ch 201 (CA).

*(b) The Derivative Action Claim*

As a result the usual rule, that Frost, as majority shareholder, is the company for these purposes, is set aside and instead Hart J focuses on the minority shareholders, who are now regarded as representing the company. Hart J therefore determines whether the company has consented to Frost's wrongdoing by investigating the actions of the minority shareholders. This would usually take the form of an analysis of whether, for example, the minority shareholders wish an action to be brought on the company's behalf against the wrongdoer.[76] It is noticeable, however, that Hart J does not rely on any such statement from Knight, but rather he relies on something which Knight does in his personal capacity, agreeing to the limited guarantee, as evidence not only of Knight's consent to the breach but also of the fact that the company's action against Frost should be barred. This seems a strange leap to make. In most cases, it is suggested, it should require something more than an action of a minority shareholder acting in his personal capacity to lead the judge to bar *the company* from an action against the wrongdoer.

*Towers v African Tug Co*[77] is often cited as authority for the view that the actions and interests of shareholders can have an impact on the availability of a remedy for the company.[78] This is an unfortunate consequence of the failure of the Court of Appeal in that case properly to disentangle personal actions by shareholders, and actions which they bring on the company's behalf, as described previously. Post-*Wallersteiner v Moir (No.2)*[79] it is clear that the claim against the wrongdoer belongs to the company and that the derivative claim should be treated first and foremost as though it were equivalent to a claim by the company itself. As a result, the misbehaviour of the minority shareholders ought to be irrelevant.

In cases involving actions actually brought by the company itself or by the liquidator of the company, whom the courts have never had any difficulty regarding as stepping directly into the company's shoes, the courts ignore the misbehaviour of a minority shareholder when determining whether to allow a derivative action to go ahead.[80] The same result should occur where the action is brought derivatively, since although the form of the claim has changed the substance has not. As a general rule the actions and interests of individual shareholders should be irrelevant in the courts' assessment of whether the

[76] See eg, *Smith v Croft (No. 2)* [1988] Ch 114.
[77] [1904] 1 Ch 558 (CA).
[78] Eg, Paul Davies (ed) *Gower's Principles of Modern Company Law* (6th ed. Sweet and Maxwell London 1997) 668–9; A J Boyle (ed) *Gore-Browne on Companies* (44th edn Jordans Bristol 1986– ) vol 2 para 28.8. See, generally, J Payne "'Clean Hands' and Derivative Actions" (2002) CLJ 76.
[79] [1975] QB 373.
[80] For example, in relation to illegal dividend payments, the court has no difficulty in allowing the claims against the directors to proceed even where some of the shareholders have received the payments in full knowledge of the illegality of those payments: *Precision Dippings Ltd v Precision Dippings Marketing Ltd* [1986] Ch 447; *Moxham v Grant* [1900] 1 QB 88.

derivative action should go forward since the issue for the court is doing justice to the company, and not to the shareholder, through the derivative action device.

However, there is a gloss to add to this otherwise straightforward proposition. In addition to asking whether the company has a right of action, the court may ask whether it should permit *this* shareholder to bring an action on behalf of the company.[81] Improper motive on the part of a shareholder should not be a valid basis for denying what is otherwise a valid derivative action.[82] However, there are two distinct arguments which could be used in order validly to deny a claim on the company's behalf being brought by *this* shareholder. Neither argument denies the company's claim, although in a small company such as ZUK the incidental practical effect of denying a remedy to *this* shareholder might be to deny the company a claim for the time being.

The first argument would allow the court to deny a remedy to a particular shareholder if that shareholder was using the derivative action as a device in order to obtain a collateral benefit for him or herself alone. In those circumstances the shareholder is abusing the derivative action jurisdiction which exists to do justice to the company. In bringing the derivative action a shareholder is acting on behalf of the company, and in a solvent company this effectively means the other shareholders. If a single shareholder has a unique interest in bringing the petition which is not shared by the other shareholders and if a majority of those shareholders are opposed to that shareholder's action then it is right and proper that the derivative action brought by that individual should be denied.[83] Therefore, the court could allow the independent shareholders of a company to determine whether it is in the interests of the company to let the derivative action brought by a particular individual to proceed.[84]

However, in certain circumstances, such as in very small companies like ZUK, there may be no independent group of shareholders who can take this decision. In such circumstances the court is left with no assistance in determining whether this

[81] Eg, *Smith v Croft (No 2)* [1988] Ch 144, 170 (Knox J); *Nurcombe v Nurcombe* [1985] 1 WLR 370.

[82] Not only is the idea of denying someone an otherwise valid claim solely on the basis of an improper motive contrary to other, arguably analogous, areas of company law (eg, *Bryanston Finance Ltd v De Vries (No 2)* [1976] Ch 63 (CA) 75 (Buckley LJ) but motive is also a concept which it is notoriously difficult for courts to ascertain, often being mixed and difficult to prove.

[83] In an insolvent company a similar situation can arise regarding the motive for presenting a winding up petition: eg, *Re Crigglestone Coal Co Ltd* [1906] 2 Ch 327; F Oditah "Winding up recalcitrant debtors" (1995) LMCLQ 107, 123–130.

[84] This principle was articulated in the context of derivative actions by Knox J in *Smith v Croft (No 2)* [1988] Ch 144 who was clear that shareholders do not have an indefeasible right to bring an action on the company's behalf and that it is proper for the court to have regard to the independent shareholders in determining whether to allow the derivative action to proceed. This is a view which has subsequently been endorsed by the Law Commission: Law Com No 246 *Shareholders Remedies* paras 6.88–6.90, albeit the recommendation of the Law Commission is that the views of the independent organ should not be regarded as conclusive, but merely one of the factors to be taken into account by the courts. See also Company Law Review Steering Group *Final Report* (DTI 2001) paras 7.46–7.51. Independence, for these purposes is measured by whether the shareholders would vote for the defendant directors in order to support them rather than for the benefit of the company: *Smith v Croft (No 2)* [1988] Ch 144, 186 (Knox J).

particular shareholder should be prevented from bringing this action on behalf of the company. If that shareholder is acting in his or her own self-interest and not in the best interests of the company then it may well be legitimate to deny the action on the ground that they are attempting to abuse the derivative action jurisdiction.

An example of this situation is *Barrett v Duckett*[85] in which a derivative action brought by a shareholder against a director for diverting company money into bank accounts held by him for himself and his wife jointly was complicated by the fact that the plaintiff's daughter was engaged in a bitter matrimonial dispute with the defendant. There was no independent group of shareholders available in this very small company, since the only shareholders were the plaintiff shareholder and the defendant director. Although the Court of Appeal used the rather more emotive, and less appropriate,[86] language of motive when denying the derivative action brought by the plaintiff, the thrust of the court's decision seems to be an aversion to allowing the plaintiff to misuse the derivative action process since the claim was not being pursued "bona fide on behalf of the company."[87] The issue of the consent, or otherwise, of the shareholder in question is clearly irrelevant in this context. This argument was not utilised by Hart J in *Knight v Frost,* and indeed there is no evidence that Knight was seeking to obtain a collateral benefit in bringing the derivative action.

The second argument is estoppel-based. In some circumstances it might be felt that a minority shareholder has effectively promised the wrongdoer that he or she will not bring a claim against the wrongdoer.[88] The minority shareholder may then be estopped from bringing a claim, and if no-one else exists to bring a claim on the company's behalf at that time then the practical effect is to deny a derivative action to the company. *Nurcombe v Nurcombe*[89] is a good example of this situation. In that case a husband and wife were the only two shareholders in a company. In their divorce proceedings it came to light that the husband had breached his duty as a director of the company in diverting a lucrative contract from the company into another company in which he held a controlling interest. The wife continued with the matrimonial proceedings when this issue came to light and the improper payment was taken into account in the lump sum awarded to the wife in matrimonial proceedings. Subsequently the wife brought an action as minority shareholder on the company's behalf against her now ex-husband in relation to this breach of duty. This action was denied by the Court of Appeal because, by choosing to continue with the matrimonial proceedings, "she was as effectively barred from commencing the [derivative] action as she would have been if she had entered into a binding obligation not to sue."[90]

[85] [1995] 1 BCLC 243 (CA).
[86] Note 82 above.
[87] [1995] 1BCLC 243 (CA) 256 (Peter Gibson LJ).
[88] The fact that a shareholder generally owes no duty to act in the best interests of the company leaves them free to make such a promise.
[89] [1985] 1 WLR 370.
[90] *Nurcombe v Nurcombe* (n 89 above) 380 (Sir Denys Buckley).

This second argument is, unlike the previous argument, based on the shareholder's consent. However, this consent is relevant to the relationship between plaintiff and wrongdoer, since this is a right which the wrongdoer can enforce personally against the shareholder. It is not relevant to the relationship between the wrongdoer and the company. It is just a practical consequence of the small size of companies like that in *Nurcombe* which makes it appear that the shareholder is consenting on the company's behalf. They are not. The company's claim is not extinguished by such consent.[91]

Hart J did not make use of this second argument either although, given that he believed that Knight did consent, this argument was open to him. Instead he took what he perceived to be Knight's consent and created from that a ratification of Frost's wrongdoing by the company. He did this via the principle set out in *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* that "the unanimous decision of all the shareholders in a solvent company about anything that the company under its memorandum of association has power to do shall be the decision of the company."[92] By the time of trial Knight was the only minority shareholder in existence. Hart J was therefore faced with two shareholders, one of whom, Frost, he already knew would not wish an action to be brought on behalf of the company. The views of Knight, as the only other shareholder, were treated by Hart J as the missing piece of the jigsaw. In Hart J's view, since Knight can be said to have consented to Frost's wrongdoing, even in a personal capacity, then all of the shareholders of the company can be regarded as consenting, and the company can therefore be regarded as consenting, barring it from a future action against Frost.[93]

Hart J's approach needs to be queried. The primary question for the court is whether it is fair and equitable to deny a remedy to *the company*, not to the shareholder. It is one thing to allow Knight's consent, if it exists, to deny him the right to bring a derivative action, something which is not extinctive of the company's claim. It is another thing entirely to turn acts of Knight in his personal capacity into something which extinguishes the company's right to bring an action. The activities of a single shareholder such as Knight, acting in his personal capacity, should not be used in this way. To do so is to misapply the concept of consent to breach of trust in the company context.

[91] This is unlikely to prevent a subsequent shareholder, or indeed a liquidator in the event of the company being wound up, subsequently being allowed to bring a claim on the company's behalf in relation to that wrong because, although there is no direct authority on this point, it seems likely that a decision not to sue is not extinctive of the company's claim: J Payne "A Re-examination of Ratification" (1999) CLJ 604, 616–617.

[92] [1983] Ch 258, (CA) 280 (May LJ) and see also *Meridian Global Funds Management Asia Ltd v The Securities Commission* [1995] 3 All ER 918 (HL) 923 (Lord Hoffmann obiter). Hart J specifically refers to this principle in his judgment: [1999] 1 BCLC 364, 374.

[93] Payne (n 91 above) 616–617.

## D CONCLUSION

This chapter has sought to explore some of the difficulties which surround the seemingly simple concept of consent to breach of trust, especially when extended beyond the central case of express trustees. The focus of the second half of the chapter has been on the translation of this concept into company law, as illustrated by the case of *Knight v Frost*. In that case, difficulties arose both as a result of the substance of the defence of consent and the application of that principle to the tripartite situation which is encountered when a company is involved.

On the first of these points, it has been argued that the test set out by Wilberforce J in *Re Pauling* was misapplied by Hart J in *Knight v Frost*. Wilberforce J's statement as to the necessary knowledge to be required of the allegedly consenting beneficiary in *Re Pauling's* was not intended to be of universal application. Instead that formulation should be understood as no more than the application to the particular facts before him of his general principle that all of the facts of the case need to be taken into account. The issue of the beneficiary's state of knowledge should be applied flexibly in the light of the facts of each case and of the overarching concepts of fairness and equity. In some cases, such as *Knight v Frost* itself, the individual ought not to be denied a subsequent remedy against the wrongdoer without being shown to have known not only, of the circumstances which give rise to the breach, but also that those circumstances do, in fact, amount to a breach of trust or fiduciary duty.

Secondly, although the judge in *Knight v Frost* claimed that the situation in company law was analogous to that in trust law this statement masks the complexity of the company law situation. As this chapter has attempted to show, the application of the consent defence in company cases is not straightforward. It is important to be clear about the operation of this principle in order to avoid the actions of shareholders such as Knight, acting in their personal capacity, being wrongly attributed to the company with the consequence that the company loses a potentially valuable legal right.

As a general rule, the actions of individual shareholders should be irrelevant to the court's assessment of whether the company should be allowed a claim against the wrongdoer. It might be appropriate for the court to deny a derivative action to a particular shareholder in certain circumstances, and in very small companies the practical effect of this may make it appear that the shareholder is acting for, or consenting for, the company. However, this should not disguise the fact that the company's claim is not, and should not be, extinguished by the actions or consent of that individual shareholder. More thought will be needed in future as the defence of consent to breach of trust is extended beyond express trustees.

# 11

# *Limitation*

WILLIAM SWADLING

TWO REASONS ARE commonly given why actions should be barred a certain period after the cause of action first accrued. Although both are framed in terms of the protection of the defendant, underlying them is a general public interest in an end to litigation. The first is to do with the unreliability of stale evidence. As Lord Salmon explained in *Birkett v James*:[1]

> When cases (as they often do) depend predominantly on the recollection of witnesses, delay can be most prejudicial to defendants and to plaintiffs also. Witnesses' recollections grow dim with the passage of time and the evidence of honest men differs sharply on the relevant facts. In some cases it is sometimes impossible for justice to be done because of the extreme difficulty in deciding which version of the facts is to be preferred . . .[2]

The second is a concern for certainty. Statutes of Limitation, it has been said, are "acts of peace"[3] or "statutes of repose."[4] After a certain time, defendants should be able to feel with confidence that they can treat as closed an incident which might once have given grounds for a claim against them.[5] "Long dormant claims," said Best CJ, "have often more of cruelty than of justice in them."[6]

A claim for breach of trust is a claim in equity, and the application of the law of limitation to claims in equity is extremely complex. Limitation at common law is purely a question of statute; the claim is either caught by the relevant limitation provision or it is not. Equity, by contrast, has both a judge-made system of limitation rules, known as "laches,"[7] and a statutorily-based set of rules. And to make matters worse, those statutory rules apply either directly, ie, where express provision is made in the statute for their application to an equitable claim, or "by analogy," ie, where no express mention of the equitable claim appears but it is treated by the courts as analogous to one barred by the statute at common law. Therefore, to discover whether in any given case a claim in equity is time-barred, a three-stage process must be gone through, in which it is asked:

1 [1978] AC 297(HL).
2 *Blinkett v James* (n 1 above) 327. See also the preamble to the Limitation Act 1540 (Appendix I).
3 *A'Court v Cross* (1825) 3 Bing 329, 332, 130 ER 540, 541 (Best CJ).
4 *Doe d Duroure v Jones* (1791) 4 TR 300, 308, 100 ER 1031, 1035 (Lord Kenyon CJ).
5 See the reference to this in the preamble of the Limitation Act 1540 (Appendix I).
6 *A'Court v Cross* (1825) 3 Bing 329, 332, 130 ER 540, 541.
7 For a fuller account of the operation of laches, see the essay by G Watt at Chapter 12 of this volume.

i. Is this an action to which there is an express statutory limit on the bringing of claims?
ii. If not, is this an action to which a court will apply a statutory limit "by analogy"?
iii. If not, is this an action nevertheless barred by the doctrine of laches?

In the context of claims for breach of trust, the answer to the second question is always in the negative, for, as we shall see, these are claims to which the statute could never apply by analogy. We shall also see that none of the three questions can be answered without a knowledge of the history of the subject and it is to that topic that we now turn. And in order to understand its particular application to breach of trust, we have to examine the history of limitation in equity generally.

## A THE HISTORY OF LIMITATION IN EQUITY

Three periods in the history of our subject will be considered: that before there were any statutes of limitation at all; that when there were statutes of limitation which made no express mention of equitable claims; and that when there were statutes of limitation making express mention of equitable claims.

### 1 Before statues of limitation

In contrast to the common law, courts of equity have always had in-built rules against delay.[8] As Lord Camden explained in *Smith v Clay*:[9]

> A Court of Equity, which is never active in relief against conscience, or public convenience, has always refused its aid to stale demands, where the party has slept upon his right, and acquiesced[10] for a great length of time. Nothing can call forth this Court into activity, but conscience, good faith, and reasonable diligence; where these are wanting, the Court is passive and does nothing.[11]

This is the equitable defence of laches. But laches, unlike its statutory counterparts, is not based on a mechanical application of a criterion of delay but

[8] A fact seemingly forgotten by Harman J in *A-G v Cocke* [1988] Ch 414, 418.
[9] (1767) 3 Bro CC 639, 29 ER 743.
[10] The books and cases often talk in the same breath of laches and acquiescence. It is, however, better to treat them separately, with laches being used to refer to inexcusable delay, and acquiescence confined to cases where the plaintiff, knowing his rights, has stood by and allowed them to be violated, as where a defendant builds in breach of covenant. The injustice of the subsequent claim then consists in allowing the defendant to fall into a trap, or perhaps in the attempt to contradict the consent given through acquiescence to the wrong: *Leeds v Amherst* (1846) 2 Ph 117, 123, 41 ER 886, 888; *De Bussche v Alt* (1878) 8 Ch D 286 (CA). The reason why the two are usually linked is that delay is often also evidence of acquiescence. But there may be acquiescence without delay, and, conversely, delay without acquiescence: J Brunyate *Limitation of Actions in Equity* (CUP Cambridge 1932) 188–189.
[11] (1767) 3 Bro CC 639n, 640n, 29 ER 743, 744.

rather on answering the question whether the delay is both unexcused and threatens hardship to the defendant. As Laddie J recently explained in *Nelson v Rye*:[12]

> The courts have indicated over the years some of the factors which must be taken into consideration in deciding whether the defence runs. Those factors include the period of delay, the extent to which the defendant's position has been prejudiced by the delay and the extent to which that prejudice was caused by the actions of the plaintiff. I accept that mere delay alone will almost never suffice, but the court has to look at all the circumstances, including in particular those factors set out above, and then decide whether the balance of justice or injustice is in favour of granting the remedy or withholding it. If substantial prejudice will be suffered by the defendant, it is not necessary for the defendant to prove that it was caused by the delay. On the other hand, the plaintiff's knowledge that the delay will cause such prejudice is a factor to be taken into account.[13]

In *Nelson v Rye* itself, a musician sought an account in equity from his manager in respect of income received by the manager on the former's behalf. Though the action was brought beyond the six-year statutory period which applied to actions in contract,[14] the plaintiff additionally alleged a breach of fiduciary duty. Laddie J held that this did not help the plaintiff's case, for the claim was anyway barred after six years under the doctrine of laches because by the time it was brought the defendant had destroyed much of the necessary paperwork and any oral evidence would be unreliable.[15]

But though laches provides a general defence to all claims for equitable relief, it never applied to claims by a *cestui que trust* against his express trustee for delivery up of the trust property itself. The reason for this is obscure, but it seems to have something to do with the unique nature of the action brought by the beneficiary in such a case, which does not allege a wrong but simply asks that a certain thing be declared always to have belonged to the beneficiary, what Roman lawyers would have recognized as the *rei vindicatio*.[16] As Sir John Romilly MR explained in *Mills v Drewitt*:[17]

12 [1996] 1 WLR 1378.

13 *Nelson v Rye* (n 12 above) 1392.

14 By s 5 of the Limitation Act 1980, "An action founded on simple contract shall not be brought after the expiration of six years from the date on which the cause of action accrued."

15 The actual decision was overruled *Paragon Finance plc v DB Thakerar (a firm)* [1999] 1 All ER 400 (CA) 416, on the ground that Laddie J should not have found a separate fiduciary duty beyond the contractual one already owed. His application of the doctrine of laches was not, however, criticized.

16 W W Buckland, *A Textbook of Roman Law from Augustus to Justinian* (3rd edn revised by P Stein, CUP Cambridge, 1963) 675; F Schulz, *Classical Roman Law* (OUP Oxford 1951) 368–372. The formula for the *vindicatio* was as follows:

> If it appears that the thing in question belongs to the plaintiff at civil law, then, unless at the direction of the judge the defendant restores the thing, let the judge condemn the defendant to pay the value of it to the plaintiff. If it does not so appear, let the judge absolve the defendant.

A full discussion of the "equitable vindicatio" is to be found in P Birks "Personal Property: Proprietary Rights and Remedies" (2000) 11 KCLJ 1.

17 (1855) 20 Beav 632, 52 ER 748.

As to the question of laches, or lapse of time, I think it does not apply to a case of this description. Lapse of time and acquiescence apply to cases where a fund is parted with or becomes deficient, and where you seek to make a trustee answerable or liable to pay something by reason of his conduct. . . . But . . . this fund . . . is the property of the [beneficiary] . . . The question now is, how this fund (which I treat exactly in the same manner as if it were now in Court) is to be divided amongst the persons entitled . . .[18]

It is, however, crucial to note that a claim against an express trustee to recover the trust assets was the only claim against an express trustee to which laches was inapplicable. As the passage from *Mills v Drewitt* shows, laches could still bar a claim for a personal response in respect of breach of an express trust. So, for example, in *Bright v Legerton*[19] the plaintiff *cestui que trust* sued the personal representatives of a deceased trustee for the income it was alleged he would have received had the trustee managed the trust property (some cottages) properly. The claim was brought 40 years after the supposed mismanagement ended, and it was held that the plaintiff's long delay made it impossible for the defendants now to prove that there had in fact been no mismanagement. Lord Campbell LC said:

A Court of Equity will not allow a dormant claim to be set up when the means of resisting it, if unfounded, have perished, much less cast a burden of proving such an affirmative as, that forty years ago cottage rents were properly collected when the witnesses who might have proved the fact have long ago been called into another state of existence. It has been beautifully remarked with respect to the emblem of Time, who is depicted as carrying a scythe and an hour-glass, that while with the one he cuts down the evidence which might protect innocence, with the other he metes out the period when innocence can no longer be assailed.[20]

## 2 Before limitation statutes made express mention of equity

Statutory periods of limitation were first introduced into the common law in the sixteenth century.[21] The Act of Limitation 1540[22] limited the bringing of certain common law forms of action relating to land within certain periods, the period

[18] *Mills v Drewitt* (n 17 above) 638, 750. See also *Re Ashwell's Will* (1859) Johns 112, 117, 70 ER 360, 362, where Page-Wood V-C said: "The only other argument against the claim of the Petitioners was that they were barred by their own laches and acquiescence; but as the fund has never been applied by the trustees to any other purpose, and is still here for whoever can make out the best title to it, that argument does not apply."
[19] (1861) 2 De GF & J 606, 45 ER 755.
[20] *Bright v Legerton* (n 19 above) 616–617, 760.
[21] This is not to say that there were no devices barring stale claims at law before this date, for many of the forms of action themselves had in-built time periods, in that they applied only to claims arising after a certain date. So, for example, by the Statute of Merton, 20 Hen III, c 8 (1235), a Writ of Right could not refer back to any time before Henry II's coronation in 1154. The problem was, however, that these limitation periods naturally grew longer as the years passed, so generating the need for a system which measured time from the moment of the cause of action itself.
[22] Appendix I.

(either 60, 50, or 30 years) varying with the form of action used. No provision was, however, made for the application of any time limits in equity. This was also the case with the Limitation Act 1623,[23] which extended the limitation régime to the common law personal actions, including the common law action for account. But though neither made express mention of equity, the Acts of 1540 and 1623 did have a profound influence in this area. To understand what that influence was, we need to know something about the various "jurisdictions" of equity. Although rarely encountered nowadays, it was usual until the Judicature Acts 1873–75 to classify the subject-matter of equity as falling into one of three "jurisdictions" of the court: the "concurrent" jurisdiction; the "auxiliary" jurisdiction; and the "exclusive" jurisdiction.

The "concurrent" jurisdiction comprises equity's responses to common law claims. An example would be a claim for specific performance of a contract. Another would be an action for an account[24] following a tort,[25] while yet another would be an injunction to restrain a threatened breach of contract or tort. The common feature of these claims is that while the common law recognises the underlying cause of action, it does not give the particular relief sought. While the "concurrent" jurisdiction might be said to be concerned with matters of substantive *relief*, the "auxiliary" jurisdiction, by contrast, deals with matters of *procedure*. It might, for example, be that in a common law action the plaintiff wants discovery of certain documents. The common law has no power to order discovery, though equity does. If discovery is ordered by a court of equity, it does so within its "auxiliary" jurisdiction. Within the "exclusive" jurisdiction fall claims which the common law does not recognise at all. The most obvious is the claim of a beneficiary to enforce a trust. Trusts have never been recognised by the common law,[26] so a beneficiary suing to enforce a trust can only obtain relief from a court of equity. Such claims are therefore said to be within the "exclusive" jurisdiction of the court.

How were limitation issues within these various jurisdictions handled? For claims within the "concurrent" jurisdiction of equity, where both equitable and common law responses were generated by the same cause of action, the courts took the view that a plaintiff could not avoid a bar on a common law response by instead seeking relief in equity. We will call this the "no side-stepping" rule. An example is provided by *Lockey v Lockey*.[27] The complaint against the defendant was that he had received the profits of an infant's estate without accounting for them. The infant waited more than six years after majority before instituting proceedings. His undoubted common law right to an account now

[23] Appendix II.
[24] Although the common law could order an account, for various procedural reasons plaintiffs preferred to bring account in equity: details in S J Stoljar, "The Transformations of Account" (1964) 80 LQR 203.
[25] As, for example, in *Phillips v Homfray* (1871) LR 6 Ch App 770 (CA) (trespass to land).
[26] Still the position today: *Parker-Tweedale v Dunbar Bank plc* [1991] Ch 12 (CA); *MCC Proceeds Inc v Lehman Brothers International (Europe)* [1998] 4 All ER 675 (CA).
[27] (1719) Prec Ch 518, 24 ER 232.

barred by the Limitation Act 1623,[28] he sought an account in equity. It was refused, despite the fact that it was not caught by any express limitation period. Lord Macclesfield LC was of the opinion that:

> where one recovers profits of an infant's estate, and six years after his coming of age he brings a bill for an account, that the Statute of Limitations is a bar to such suit, as it would be to an action of account at common law; for this receipt of profits of an infant's estate is not such a trust as, being a creature of a court of equity, the statute shall be no bar to, for he might have his action against him at law, and therefore no necessity to come into this court for an account; but the reason why such bills are brought here, is from the nature of the demand, that they might have discovery of books, papers, and the party's oath, for the more easy taking of the account, which they cannot so well do at law; but if the infant lies by for six years after he comes of age, as he is barred of his action of account at law, so shall he be of his remedy in this court, and there is no sort of difference in reason between the two cases.[29]

For claims within the "auxiliary" jurisdiction of the court, where superior equitable procedural devices were invoked in support of common law claims, the same approach was taken. Thus, in *Widdowson v Earl of Harrington*[30] the court rejected a suit for discovery on the ground that the action at law to aid which it was sought was already barred by the 1540 Act.

As for claims within the "exclusive" jurisdiction of equity, where the plaintiff had no legal claim at all, the judges followed the lead given by the legislature and adopted the statutory period of limitation as the time limit for laches. As Lord Camden explained in *Smith v Clay*:[31]

> But as the Court has no legislative authority, it could not properly define the time of bar, by a positive rule to an hour, a minute, or a year; it was governed by circumstances. But as often as Parliament had limited the time of actions and remedies, to a certain period, in legal proceedings, the Court of Chancery adopted that rule and applied [it] to similar cases in equity. For when the legislature had fixed the time at law, it would have been preposterous for equity (which, by its own proper authority, always maintained a limitation) to countenance laches beyond the period, that law had been confined to by Parliament.[32]

In cases falling within the "concurrent" or "auxiliary" jurisdictions, the Limitation Acts were said to apply "by analogy."[33] One point of contention was exactly what this meant. Did the statutory provisions apply as a variant of laches, in the same way that *Smith v Clay* applied the statutory period to claims

[28] Limitation Act 1623, s 3.
[29] (1719) Prec Ch 518, 24 ER 232.
[30] (1820) 1 J & W 532, 37 ER 471.
[31] (1767) 3 Bro CC 639n, 29 ER 743.
[32] *Smith v Clay* (n 31 above).
[33] The idea that the statute could apply by analogy is nowadays provided for by the Limitation Act 1980 (s 36(1)) itself (see Appendix VI). This raises the interesting question whether in such circumstances laches applies because of the rules of equity or because of the rules of statute: see the discussion of Megarry J in *Tito v Waddell (No 2)* [1977] Ch 106, 250–251, a decision on s 2(7) of the Limitation Act 1939 (Appendix V).

within the court's "exclusive" jurisdiction? Or did they do so because the statute applied directly to the claim in question even though not expressed to do so? Some took the view that since "equity follows the law," the statute applied directly. So, for example, in *Hovenden v Lord Annesley*[34] Lord Redesdale said:

> It is a mistake in point of language, to say that courts of equity act merely *by analogy* to the statutes; they act in *obedience* to them. The statute of limitations, applying itself to certain legal remedies, for recovering the possession of land, for recovering of debts, etc, equity, which in all cases follows the law, acts on legal titles, and legal demands, according to matters of conscience which arise, and which do not admit of the ordinary legal remedies; nevertheless, in thus administering justice according to the means afforded by a Court of Equity, it follows the law. . . . I think, therefore, courts of equity are bound to yield obedience to the statute of limitations upon all legal titles and legal demands, and cannot act contrary to the spirit of its provisions. I think the statute must be taken virtually to include courts of equity; for when the legislature by statute limited the proceedings at law in certain cases, and provided no express limitations for proceedings in equity, it must be taken to have contemplated that equity followed the law, and, therefore, it must be taken to have virtually enacted in the same case a limitation for courts of equity also.[35]

Others took the view that the statute applied only indirectly, with the court simply being unwilling to contradict the position which obtained at common law. So, for example, in *Gibbs v Guild*[36] Holker LJ said:

> In some cases although the proceeding in equity was not within the language or spirit of the Statute of Limitations yet nevertheless the Courts of Equity have said that there shall be a limitation, and though we are not bound by the Statute of Limitations yet we will act upon the spirit of the statute . . . .[37]

The distinction between direct and indirect application was important where the defendant fraudulently concealed the existence of the cause of action. The 1540 and 1623 statutes made no exception for fraudulent concealment. But in the law of laches, that exception was in-built, for, as we have seen,[38] laches is inexcusable delay, and delay caused by the defendant's fraudulent concealment is excusable delay; so far as laches is concerned, the clock only begins to tick from the time when the cause of action was discovered or with reasonable diligence could have been discovered. What then of a claim actionable both at law and in equity the existence of which was fraudulently concealed from the plaintiff. If the common law claim was statutorily-barred, could the plaintiff simply switch to equity? Or would the statutory bar apply in equal measure to

[34] (1806) 2 Sch & Lef 607.
[35] *Hovenden v Lord Annestey* (n 34 above) 629 (emphasis in original).
[36] (1882) 9 QBD 59 (CA).
[37] *Gibbs v Guild* (n 36 above) 74. Cf the attitude taken in the area of claims in unjust enrichment involving illegality, where the concern of the law is to prevent unjust enrichment claims stultifying the rules against the direct enforcement of illegal contracts: P Birks "Recovering Value Transferred Under an Illegal Contract" (2000) 1 Theoretical Inquiries in Law 155.
[38] Text from n 8 above.

the equitable claim? If application by analogy was simply part of laches, in other words, if the statute applied only indirectly, then the statutory limitation period would not bar the equitable claim. But if the statute applied directly, the claim would be barred. The view taken by the courts was that the equitable claim was not barred. So, for example, in *Booth v Lord Warrington*,[39] an action brought in equity nine years after payment to recover a fraudulently induced transfer of money was held not to be barred by lapse of time, the court rejecting the defendant's argument that the claim was time-barred by analogy with the Limitation Act 1623[40] (which would have barred the common law claim for money had and received).[41] But the case cannot be said to have settled the matter for, though a decision of the House of Lords, the reasoning of the court is not revealed.[42] And the fact that the result in this decision was later incorporated into statute as section 26 of the Real Property Limitation Act 1833[43] meant that the issue never had to be resolved.

We have already seen how laches could never be pleaded by an express trustee where the claim was to recover trust assets. Not surprisingly, the courts held that neither the 1540 or the 1623 statutes had abrogated that rule. But an uncalled-for and different explanation for the exception was now given by Lord Redesdale in *Hovenden v Lord Annesley*.[44] He said:

> [I]f a trustee is in possession and does not execute his trust, the possession of the trustee is the possession of the *cestui que trust*; and if the only circumstance is, that he does not perform his trust, his possession operates nothing as a bar, because his possession is according to his title: just as in the case of a lessee for years, though he does not pay his rent for 50 years, his possession is no bar to an ejectment after the expiration of this term, because his possession is according to the right of the party against whom he seeks to set it up.[45]

Since they had not altered the existing law, it is not immediately apparent why Lord Redesdale felt the need to explain why the two statutes did not bar this type of claim. One explanation, however, may be his view noted above,[46] contrary to *Booth v Lord Warrington*,[47] that the Limitation Acts were directly applicable to equitable claims.[48] But in any case, it simply is not true to say that

[39] (1714) 4 Bro PC 163, 2 ER 111.
[40] Appendix II.
[41] For an unconvincing argument that even the common law would have allowed an exception to the statute where the cause of action had been concealed from the plaintiff by the defendant's fraud, see J Brunyate *Limitation in Equity* (CUP Cambridge 1932) 40–49.
[42] Though Brett LJ in *Gibbs v Guild* (1882) 9 QB 59 (CA), 70–72, deduced that they decided in the way mentioned in the text.
[43] Appendix III.
[44] (1806) 2 Sch & Lef 607.
[45] *Hovenden v Lord Annesley* (n 44 above) 633. This explanation was recently adopted by Millett LJ in *Paragon Finance Ltd v Thakerar* [1999] 4 All ER 400 (CA) 408.
[46] Text to n 34 above.
[47] (1714) 4 Bro PC 163, 2 ER 111.
[48] Text from n 36 above.

the possession of the trustee is the possession of the beneficiary, for the beneficiary has no right to possession at common law whatever.

We have noticed that the exception in favour of claims to deliver up trust assets applied to express trustees. Those holding under constructive trusts were outwith the exception, with the result that, for cases within the concurrent and auxiliary jurisdiction, a statutory bar on the common law claim could not be side-stepped by alleging a constructive trust, and for claims within the original jurisdiction, the doctrine of laches continued to apply. But given that Lord Redesdale felt the need to explain why no statutory rule of limitation applied against an express trustee for delivery-up of the trust property, he had also to explain why the exception did not apply to constructive trustees. In other words, he had to explain why constructive trustees *could* take advantage of the statute and plead limitation as a defence. Claims to constructive trusts often involve allegations of fraud. In *Hovenden v Lord Annesley*[49] Lord Redesdale used this as a reason to explain why the courts would apply limitation periods to such claims:

> But the question of fraud is of a very different description; that is a case where a person who is in possession by virtue of that fraud is not, in the ordinary sense of the word, a trustee, but is to be constituted a trustee by a decree of a court of equity, founded on the fraud, and his possession in the mean time is adverse to the title of the person who impeaches the transaction, on the ground of fraud . . . .[50]

This explanation was just as unnecessary as his explanation as to why express trusts were excepted. Moreover, as the example of the constructive trust in *Walsh v Lonsdale*[51] shows, not all constructive trusts involve fraudulent conduct. Nevertheless, it was built upon four years later in *Beckford v Wade*,[52] an appeal to the Privy Council from the island of Jamaica. In that country there was a statute which operated, not as statutes of limitation do in England by barring a claim after a certain lapse of time, but in giving a title good against the world[53] to a person who had occupied land for seven years or more under a "Deed, Will, or other conveyance." The defendant was in possession of some land, having obtained a conveyance of it from the executors of a deceased's estate. The plaintiff sued many years later for possession, claiming, *inter alia*, that the conveyance to the defendant had been procured by fraud, and that this fact took the case out of the statute, for it meant that the defendant was turned

49 (1806) 2 Sch & Lef 607.

50 *Hovenden v Lord Annesley* (n 49 above) 633.

51 (1882) 21 ChD 9 (CA).

52 (1810) 17 Ves 87, 34 ER 34.

53 The English Limitation Acts have never operated in this positive manner. So, for example, the title which a possessor of land has after the expiration of the statutory period will not bar the title of someone with a better title (such as a landlord) than that of the person whose claim is barred: *St Marylebone Property Co Ltd v Fairweather* [1963] AC 510 (HL). A similar adherence to the doctrine of relativity of title is evident in *National Employers' Mutual Insurance Association Ltd v Jones* [1990] 1 AC 24 (HL) on the operation of the *nemo dat* exception in s 25 of the Sale of Goods Act 1979.

into a trustee for her. But since the trust, if there was one, was constructive and not express, it was held that the exception had no application and the statutory period applied. Sir William Grant MR said:

> It is certainly true that no time bars a direct trust, as between *cestui que trust* and trustee; but, if it is meant to be asserted, that a Court of Equity allows a man to make out a case of constructive trust at any distance of time, after the facts and circumstances happened out of which it arises, I am not aware, that there is any ground for a doctrine, so fatal to the security of property as that would be; so far from it, that not only in circumstances where the length of time would render it extremely difficult to ascertain the true state of the fact, but where the true state of the fact is easily ascertained, and where it is perfectly clear, that relief would originally have been given upon the ground of constructive trust, it is refused to the party, who after long acquiescence comes into a Court of Equity to seek that relief.[54]

Thus, we have moved from a position where the explanation of why the Act applied to claims against constructive trustees was that plaintiffs could not simply side-step the legislation by suing in equity, to an explanation based on the difficulties of proof in the case where a trust arises by operation of law rather than by some manifestation of consent. This is not particularly important in itself, except that it might then be taken a stage further. What about express trusts which are difficult to prove, because, for example, they are not evidenced in writing? Should the Limitation Acts also apply to them by analogy? The answer is clearly that they should not, for such trusts are within the exclusive jurisdiction of equity, a jurisdiction to which the Limitation Acts never applied. But some judges toyed with the idea they were caught by the statutes.[55]

## 3 Limitation Acts Making Express Mention of Equity

This brings us to the present-day model for statutes of limitation, in which express mention is made of equitable claims. But we should note that, in contrast to the position at common law, the statutes do not purport to give an exhaustive statement of the operation of limitation in equity, preferring instead to enact certain rules, create exceptions to those rules, and leave in place any remaining equitable jurisdiction. In fact, they often do little more than preserve the existing law.

We need to consider five statutes: the Real Property Limitation Act 1833; the Judicature Act 1875; the Limitation Act 1880; the Limitation Act 1939; and the present incumbent, the Limitation Act 1980.

[54] (1810) 17 Ves 87, 97, 34 ER 34, 38.

[55] So, for example, Kindersley V-C in *Petre v Petre* (1853) 1 Drewry 371, 61 ER 493, defined an express trust as one which was expressly declared by a deed or will or some other *written* instrument. However, in *Rochefoucauld v Boustead* [1897] 1 Ch 196 the Court of Appeal were firmly of the view that a trust was still express even where it was not evidenced in writing. Logically, this is the only defensible approach, though Millett LJ takes a different view in *Paragon Finance plc v D B Thakerar Ltd (a firm)* [1999] 1 All ER 400 (CA) 419.

### *(a) Real Property Limitation Act 1833*[56]

The 1833 statute was an update on the 1540 Act, designed to rationalise the various limitation periods which then existed for land. It enacted, subject to some exceptions, a general rule that actions to recover land were barred after 20 years. As with the 1540 statute, these periods on their face only applied to actions at common law. But the statute for the first time enacted a rule that these periods could not be avoided by a plaintiff switching his claim from law to equity. In other words, the 1833 Act enacted the no side-stepping rule. Thus, section 24 provided:

> [N]o Person claiming any Land or Rent in Equity shall bring any Suit to recover the same but within the Period during which by virtue of the Provisions herein-before contained he might have made an Entry or Distress or brought an Action to recover the same respectively if he had been entitled at Law to such Estate, Interest, or Right in or to the same as he shall claim therein in Equity.

Apart from section 24, four other sections made express reference to equitable claims. But like section 24, they did no more than enact pre-existing judge-made rules in statutory form. The first is the obscurely worded section 25. It provided:

> [W]hen any Land or Rent shall be vested in a Trustee upon any express Trust, the Right of the Cestuique Trust, or any Person claiming through him, to bring a Suit against the Trustee, or any Person claiming through him, to recover such Land or Rent, shall be deemed to have first accrued, according to the Meaning of this Act, at and not before the Time at which such Land or Rent shall have been conveyed to a Purchaser for a valuable Consideration, and shall then be deemed to have accrued only as against such Purchaser and any Person claiming through him.

This is not, as at first it might appear, a statutory enactment of the rule that neither laches nor any period prescribed by the 1833 Act can run against an express trustee still holding trust property. A closer examination reveals that though the section does indeed talk of express trusts, it deals with claims, not against trustees, but against purchasers from trustees, and is meant to provide a limitation period for fraudulent purchases from trustees, leaving untouched the position of the trustee himself. It is in fact a statutory enactment of the decision of Lord Kenyon MR in *Bonny v Ridgard*.[57] In that case a trustee, in breach of trust, sold land to a purchaser not in good faith. Many years later, a suit was brought by the beneficiaries against the purchaser to recover the land. Sir Thomas Sewell held that the purchaser was a trustee, with the result that no limitation period applied. His decision was reversed by the Master of the Rolls, who said that though the purchaser had full notice of the beneficial interests and was therefore a trustee of the land, by analogy with the Statute of Limitations,

[56] Appendix III.
[57] Cited in *Andrew v Wrigley* (1792) 4 Bro CC 125, 138, 29 ER 812, 818.

the length of time which had passed now barred the claim. The case was approved by Sir William Grant MR in 1810 in *Beckford v Wade*,[58] who used it to illustrate the different approach taken to claims made against express trustees and those against constructive trustees, with *Bonny v Ridgard* falling into the latter category. The case would therefore have been well-known to the draftsman of the 1833 Act, though precisely why he felt the need to enact it in statutory form is not immediately clear.[59]

The next provision is section 26. It will be recalled that the courts of equity had decided that, like the law of laches, the limitation periods provided by statute should not in the case of a fraudulently concealed cause of action begin to run until the plaintiff with reasonable diligence could have discovered the existence of his cause of action.[60] By section 26, this rule was given statutory force. We can only guess that the reason for this was to clear up any controversy over the rule's application which may have been generated by Lord Redesdale's judgment in *Hovenden v Lord Annesley*.[61] From now on, there could be no doubt that the fraud exception to laches applied not just to claims within the exclusive jurisdiction but also to those within the concurrent and auxiliary jurisdictions.[62]

### *(b) Judicature Act 1873*

As is well-known, the Judicature Act 1873 is one of the statutes which fused the courts of law and equity into one Supreme Court of Judicature. It had only one thing to say about limitation, in section 25(2):

> No claim of a cestui que trust against his trustee for any property held on an express trust, or in respect of any breach of such trust, shall be held to be barred by any Statute of Limitations.

This is a strange provision, for, as we have seen,[63] claims against express trustees for recovery of trust property, and claims against express trustees for breach of trust, both being claims within the exclusive jurisdiction of equity, were not covered by any statutes of limitation whatever, though the latter was of course subject to the doctrine of laches. We can only presume that the provision was enacted from an abundance of caution.[64]

[58] (1810) 17 Ves 87, 97–98, 34 ER 34, 38.

[59] It may, however, be because *Bonny v Ridgard* was poorly reported: see (1810) 17 Ves 87, 97–98, 34 ER 34, 38.

[60] Text from n 37 above.

[61] (1806) 2 Sch & Lef 607.

[62] The two remaining sections dealing with equitable claims were s 27, which preserved the jurisdiction of the court in respect of laches for cases not already barred by the operation of the statute, and s 28, which enacted the rule that the equitable right to redeem was barred against a mortgagee who had been in possession of the mortgaged land for more than 20 years, a rule already well-established in the case-law: *Barron v Martin* (1815) 19 Ves 327, 34 ER 539; *Cholmondely v Clinton* (1821) 4 Bligh 1, 4 ER 721.

[63] Text from n 24 above.

[64] It may be that the threefold division of the jurisdiction of equity was not expected to survive the enactment of the legislation.

### *(c) Trustee Act 1888*[65]

The Trustee Act 1888 had one section relevant to our enquiry, section 8. It is vital to understand section 8, for it forms the foundation of the modern law. It provided as follows:

In any action or other proceeding against a trustee or any person claiming through him, except where the claim is founded upon any fraud or fraudulent breach of trust to which the trustee was party or privy, or is to recover trust property, or the proceeds thereof still retained by the trustee, or previously received by the trustee and converted to his use, the following provisions shall apply:-

(a) All rights and privileges conferred by any statute of limitations shall be enjoyed in the like manner and to the like extent as they would have been enjoyed in such action or other proceeding if the trustee or person claiming through him had not been a trustee or person claiming through him;

(b) If the action or other proceeding is brought to recover money or other property, and is one to which no existing statute of limitations applies, the trustee or person claiming through him shall be entitled to the benefit of and be at liberty to plead the lapse of time as a bar to such action or other proceeding in the like manner and to the like extent as if the claim had been against him in an action of debt for money had and received . . .

In addition, section 1(3) provided:

For the purposes of this Act the expression "trustee" shall be deemed to include an executor or administrator and a trustee whose trust arises by construction or implication of law as well as an express trustee.

What exactly was section 8(1) trying to do? The wording is not felicitous,[66] and in order to understand it we need to take each part separately. Section 8(1)(a) simply enacted in statutory form the existing judge-made rule that plaintiffs with a time-barred common law claim could not avoid the statute by suing instead in equity, what we have previously called the "no side-stepping" rule. There are three pieces of evidence for this conclusion. First, the opening words of section 8(1) exclude claims to deliver up trust property. The only claims section 8(1)(a) can therefore contemplate are personal ones. Second, it cannot cover personal claims against express trustees for breach of trust, for in those cases there is no equivalent common law action on which any statutory limitation period could bite. And third, section 1(3) makes it clear that the word "trustee" extends to constructive trustees, and the sort of claims caught by the "no side-stepping" rule are claims against persons as constructive trustees. If this is right, then section 8(1)(a) achieved precisely nothing, though we should know by now that there is nothing odd about that in this area.

[65] Appendix IV.

[66] A view shared by Brunyate: J Brunyate, *Limitation of Actions in Equity* (CUP Cambridge 1932) 114.

Exactly the same is true of section 8(1)(b). Section 8(1)(a), in that it enacted the "no side-stepping" rule, was concerned with cases coming within equity's concurrent and auxiliary jurisdictions. By contrast, section 8(1)(b) seems to be restricted to claims within the exclusive jurisdiction, and then only to claims against express trustees for innocent breaches of trust. There are four pieces of evidence for this. First, unlike section 8(1)(a), section 8(1)(b) does not talk of a common law limitation period applying, but specially enacts one for equitable claims. Second, claims to recover the trust property itself or its traceable substitute still in the trustee's hands are excluded by the opening words of section 8. Third, claims in respect of the conversion by the trustee of the trust property to his own use are also excluded, again by the same opening words. And fourth, fraudulent breaches of trust are excluded altogether. All that is left, therefore, are claims by beneficiaries for innocent breaches of trust, for example, negligent investment, paying out to a non-beneficiary, and so on.[67] But, as we have previously noted,[68] such claims were always subject to the doctrine of laches, with the courts adopting the statutory limitation periods as the period of limitation. Once again, therefore, the statute does nothing more than to put into statutory form the existing rules of equity.

### *(d) Limitation Act 1939*[69]

Section 8 of the Trustee Act 1888 was replaced by section 19 of the Limitation Act 1939. It provided:

> (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action-
>
> (a) in respect of fraud or any fraudulent breach of trust to which the trustee was a party or privy; or
>
> (b) to recover from the trustee trust property or the proceeds thereof in the possession of the trustee, or previously received by the trustee and converted to his use.
>
> (2) Subject as aforesaid, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued . . . .

Like section 8 of the Trustee Act 1888, section 19 made no change in the law. Section 19(1) merely reproduced the opening words of section 8(1) of the 1888 Act, and section 19(2) was no different in substance from section 8(1)(b). The curious might enquire of the fate of section 8(1)(a) of the 1888 Act, the subsection which enacted the "no side-stepping" rule. The answer is that the rule it

[67] In *re Richardson, Pole v Pattenden* [1920] 1 Ch 423 (CA) 440, Warrington LJ said that "The Trustee Act of 1888 was, it is well known, passed in order to remove what was thought to be a hardship on innocent trustees . . ."
[68] Text from n 33 above.
[69] Appendix V.

contained was preserved, though now in a different way. The 1939 Act was the first comprehensive limitation statute to be passed following the abolition of the forms of action in the previous century.[70] The statute therefore no longer used the language of the common law *forms* of actions but talked instead of *causes* of action. Section 2(1), for example, provided that no action could be brought in respect of "actions founded on simple contract or on tort" after the expiration of six years from the date on which the cause of action accrued. Given that the statute did not differentiate between common law and equitable claims, obviously caught by this limitation period were claims both at common law and in equity in respect of contracts and torts.[71] But curiously, one action was specifically mentioned. Section 2(2) provided that "An action for an account shall not be brought in respect of any matter which arose more than six years before the commencement of the action." It is a matter of some debate whether this provision was intended to refer only to the common law action of account, or to also extend to equity,[72] though the view that only common law account was included is likely given that a subsequent provision, section 2(7), seems to deal with the equitable action of account. It provided:

> This section shall not apply to any claim for specific performance of a contract or for an injunction or for *other equitable relief*, except in so far as any provision thereof may be applied by the court by analogy in like manner as the corresponding enactment repealed by this Act has heretofore been applied.[73]

In *Tito v Waddell (No 2)*,[74] Megarry J held (obiter) that the combined effect of sections 2(2) and 2(7) was to bar actions for account in equity where the underlying cause of action was breach of contract but not to bar claims against what might be called "pure" fiduciaries. In other words, claims for an account within the concurrent jurisdiction were barred after six years, but not claims within the exclusive jurisdiction, though such claims were of course barred by laches.[75]

There is one further provision to consider. With the "no side-stepping" rule now made redundant by the new style of drafting, the definition of trust and trustee needed no longer to include constructive trusts and trustees, as it had done under the 1888 Act. But this seems to have been missed, for in similar

[70] By the Common Law Procedure Act 1852.
[71] One problem with this approach was that while the draftsman may have known all the forms of action, the same was not true of the causes of action. One obvious omission was claims in unjust enrichment, probably based on the erroneous view of Viscount Haldane LC in *Sinclair v Brougham* [1914] AC 398 (HL) 415, "that so far as proceedings in personam are concerned, the common law of England really recognizes (unlike the Roman law) only actions of two classes, those founded on contracts and those founded on tort," a view only corrected after the 1939 Act was passed, in *Fibrosa Spolka Akcyjna v Fairbairn Lawson Combe Barbour* [1943] AC 32 (HL).
[72] See the discussion of Megarry J in *Tito v Waddell (No 2)* [1977] Ch 106, 250–252.
[73] Emphasis supplied.
[74] [1977] Ch 106, 250–252.
[75] The reason why this distinction was important in *Tito v Waddell (No 2)* [1977] Ch 1–6 was that, though statutory limitation had been pleaded, laches had not.

fashion to section 1(3) of the Trustee Act 1888, section 31 of the 1939 Act provided that the words "trust" and "trustee" were to have the meaning they bore in the Trustee Act 1925, and by section 68(1)(17) of that Act the expressions "trust" and "trustee" extended to implied and constructive trusts.

Finally, we should note section 26. It will be recalled that section 26 of the Real Property Limitation Act 1833 said that for claims within equity's concurrent and auxiliary jurisdictions time should not begin to run in cases of concealed fraud until the cause of action could with reasonable diligence have been discovered by the plaintiff. This, as we have seen,[76] was anyway a rule of laches, for concealed fraud was a good excuse for delay. We also saw that at common law concealed fraud did not prevent time running. Section 26, *inter alia*, reversed this rule, providing that concealed fraud stopped time running both at law and in equity. It provided:

> Where, in the case of any action for which a period of limitation is prescribed by this Act, either-
>
> (a) the action is based upon the fraud of the defendant or his agent or of any person through whom he claims or his agent, or
>
> (b) the right of action is concealed by the fraud of any such person as aforesaid, or
>
> (c) the action is for relief from the consequences of a mistake,
>
> the period of limitation shall not begin to run until the plaintiff has discovered the fraud or the mistake, as the case may be, or could with reasonable diligence have discovered it.

The wording of section 26 of the 1939 Act is obviously much wider than section 26 of the 1833 Act. It is, for instance, not confined to fraudulent concealment, but covers fraud *simpliciter* and mistake. And not only does it encompass all common law claims and claims within equity's concurrent and auxiliary jurisdiction, it would also seem to apply to the one claim within equity's exclusive jurisdiction to which a limitation period is provided by section 19 of the 1939 Act, viz the personal claim for breach of trust by an express trustee. But this was probably an unintended result. There are two pieces of evidence for this. First, the enactment of a limitation period for breach of trust was made for the first time in the Trustee Act 1888, whereas section 26 of the 1939 Act re-enacts (albeit in expanded form) section 26 of the 1833 Act; in 1833 no statutory period applied to personal claims for breach of trust. Second, anti-fraud provisions are in any case built in to section 19, so that there would be no need to turn to section 26.

### *(e) Limitation Act 1980*[77]

The Limitation Act 1980 replaces the Limitation Act 1939 and is the statute currently in force. However, so far as equity is concerned, it makes very little

[76] Text from n 38 above.
[77] Appendix VI.

change to the 1939 Act. Thus, section 21 of the 1980 Act reproduces in almost exact form section 19 of the 1939 Act. The relevant parts of section 21 provide:

(1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action–

(a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or

(b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use.

. . .

(3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued.

Like the 1939 Act, no mention is made of the "no side-stepping" rule, because once again the statute talks in terms of causes rather than forms of action, and once again a provision similar to section 2(2) of the 1939 Act is enacted, though this time in section 23, which provides:

An action for an account shall not be brought after the expiration of any time limit under this Act which is applicable to the claim which is the basis of the duty to account.

The controversy as to whether this section applies to the equitable action of account is not, however, resolved, the rule contained in section 2(7) of the 1939 Act being preserved by section 36(1) of the 1980 Act.[78]

Two further points should be noted. First, the Act, in section 32, re-enacts section 26 of the 1939 Act, though, as was argued with respect to the 1939 Act, this should not be seen as having any application to section 21. Second, like the 1939 Act, the 1980 Act adopts as its definition of "trust" and "trustee" the meanings attributed to those words by the Trustee Act 1925,[79] with the result that constructive trustees are included. But, for the reasons already discussed in relation to the 1939 Act, this provision was unnecessary.

### B APPLICATION TO BREACH OF TRUST

In order to outline the current law of limitation in respect of breach of trust, it becomes necessary to enumerate the sorts of claims which may be encompassed

[78] Section 36(1) forces courts to ask whether the claim before them would have been barred by the application of laches by analogy before the enactment of the 1939 Act, a requirement recently castigated by Sir Christopher Staughton in *Cia de Seguros Imperio v Heath (REBX) Ltd* [2001] 1 WLR 112, 124 (CA).

[79] Limitation Act 1980, s 38(1).

under this heading, both against trustees themselves, and against strangers to the trust. We will consider first claims against trustees.

## 1 Claims against Trustees

So far as concerns claims to convey to the beneficiaries of the trust the rights being held for them on trust, there is no statutory limitation period.[80] And as has been explained above, the doctrine of laches has never applied to such a claim.[81]

As regards personal claims against the trustee, everything will turn on how we define "breach of trust." One major difficulty is that there is no agreement in English law as to what counts as a breach of trust. As Megarry V-C pointed out in *Tito v Waddell (No 2)*[82] the expression "breach of trust" has never been defined in any English case or textbook. Two views are possible. The first, wider, view is that every omission or violation by trustees of duties which equity imposes upon them is a breach of trust. The second, narrower, view is that trustees only commit a breach of trust when they violate a duty owed by them to the beneficiaries *qua* trustees. In other words, only breaches of duties which are unique to trustees are breaches of trust. If non-trustees are also subject to the same duty, then breach of that duty cannot be a breach of trust. One breach of equitable duty which on this view would not be a breach of trust is a breach of fiduciary duty, for it is not only trustees who equity says must avoid potential conflicts of interest.[83]

Broadly speaking, a trustee is accountable for his management of the trust fund. That primary obligation of accountability is the particular means by which all management obligations of a trustee are enforced. That accountability is, as a matter of history, the matrix of the substantive obligations which will be described below. That is, they are inferences from the way in which the account worked. It is still true that the account remains the mechanism for realising those obligations, though they are increasingly discussed as though they had an independent life of their own.

We should immediately note that the obligation to account here described is not one caught by section 23 of the Limitation Act 1980. As we have seen, that

[80] Limitation Act 1980, s 21(1)(b).
[81] Above, text to n 17.
[82] [1977] Ch 106, 247.
[83] The converse view, that every breach of trust is a breach of fiduciary duty is untenable. As Millett LJ pointed out in *Bristol & West BS v Mothew* [1998] Ch 1 (CA) 18, "the distinguishing obligation of a fiduciary is the obligation of loyalty." It can hardly be said that a trustee will be in breach of his duty of loyalty if he makes a negligent investment decision or innocently pays the wrong beneficiary, for in neither case is he putting his own interests first.

Cases in which non-trustees were held subject to a fiduciary duty are legion. Examples include *Lister v Stubbs* (1890) 45 Ch D 1(CA) (buyer for manufacturer); *Boardman v Phipps* [1967] 2 AC 46 (HL) (solicitor to trust fund); *A-G for Hong Kong v Reid* [1994] 1 AC 324 (PC) (government prosecutor).

provision is a part of the "no side-stepping" rule of equity, and will therefore only apply to cases within the court's concurrent or auxiliary jurisdiction. By contrast, a claim against a trustee for breach of trust is clearly a claim within the court's exclusive jurisdiction. Just as we have argued that section 32 has no application to section 21,[85] nor should section 23.[86]

Accountability aside, there are three central obligations cast upon a trustee: to promote the interests of the beneficiary; to stay within the terms of the trust; and to act disinterestedly. The first two are unique to trustees and so a breach of those obligations will undoubtably amount to a breach of trust. Breach of the third obligation will only count as a breach of trust if the wider view set out immediately above is followed.

## 2 The Obligation to Promote the Interests of the Beneficiary

The trustee's primary obligation is to preserve and promote the interests of the beneficiary. He must act for the beneficiaries as a prudent person of business would act in his own affairs.[87] Any breach of this obligation causing loss will expose the trustee to a personal claim for compensation, enforced through his duty to account.

We have already seen how such a claim, not being a claim against an express trustee to recover the trust property itself, was from the start one to which the doctrine of laches applied. We also saw that the claim, being within the exclusive jurisdiction of equity, was not caught by the early limitation statutes, even when applied "by analogy," but that, taking their lead from the legislature, the courts applied the statutory periods via the doctrine of laches.[88] We then saw this rule enacted in section 8(1)(b) of the Trustee Act 1888 (adopting a six-year period), re-enacted in section 19(2) of the Limitation Act 1939, and finally enacted again in section 21(3) of the Limitation Act 1980.

There are a number of points to notice about the operation of this statutory provision. First, it has been held that the statutory enactment has ousted any recourse to the doctrine of laches for cases coming within its purview.[89] In other words, it will not be possible for the defendant to argue for a shorter limitation period than that provided by the statute.

Second, the section only provides a limitation period for claims in respect of innocent breaches of trust, fraudulent breaches being excepted by section 21(1)(a). We have seen how fraud in equity could prevent laches applying, for concealment of the cause of action made the delay in bringing suit excusable.

[85] Specifically in relation to the Limitation Act 1939: p 334 above.
[86] In *A-G v Cocke* [1988] Ch 414 Harman J did indeed hold that claims against express trustees to account were not within s 23, though not for the reasons here stated.
[87] *Speight v Gaunt* (1883) 9 App Cas 1(HL); *Learoyd v Whiteley* (1887) 12 App Cas 727 (HL).
[88] Text to n 33 above.
[89] *Re Pauling's ST* [1964] Ch 303 (CA) 353, a decision on the 1939 Act.

But two questions arise under the 1980 statute. First, what is the meaning of "fraud" for the purposes of section 21(1)? And second, if fraud is present, so that the six-year period laid down in section 21(3) does not apply, what period of limitation, if any, will do so?

The first question is difficult for two reasons: first, because in equity fraud could mean actual fraud or constructive fraud,[90] and second, because, though there might be fraud, there might be no fraudulent *concealment*. It is submitted that the correct answer is that fraud here means a deliberate concealment of the cause of action. As to the first difficulty, the statute must mean actual rather than constructive fraud, for constructive fraud has been defined as any "breach of the sort of obligation which is enforced by a court that from the beginning regarded itself as a court of conscience,"[91] and, since the duty properly to invest is such a duty, all breaches of this duty would be fraudulent, with the result that no trustee could ever take advantage of section 21(3).[92] As to the second difficulty, the reason why the fraud must amount to a deliberate concealment is that since section 21(3) simply enacts one rule of laches (that claims for innocent breach of trust are barred after six years), the other parts of section 21 must also be consistent with the rules of laches. An intentional breach of trust, therefore, is not in itself fraud for the purposes of section 21; what matters is whether the intentional breach of trust was deliberately concealed from the beneficiaries. And, for the reasons already discussed,[93] the provision in section 32 of the 1980 Act that prevents limitation periods running in cases of fraud, can have no application to a claim for breach of trust.

If there is fraudulent concealment, then section 21(1) provides that "no period of limitation prescribed by this Act shall apply" to a claim for breach of trust. There being no other statutory period, we are thrown back on the doctrine of laches. And the doctrine of laches, as we have seen, provides that time will only begin to run when the breach of trust could with reasonable diligence have been discovered. There is no long-stop for such claims.

## 3 The Obligation to Keep within the Terms of the Trust

There are limits on the ways in which the trustee may deploy the rights which he holds on trust. Most obviously, he must not give those rights to persons other than the beneficiaries. But he also has limited powers in investing and re-

[90] For the difference between actual fraud and constructive fraud see J McGhee, *Snell's Equity* (30th edn Sweet and Maxwell London 2000) 610.
[91] *Nocton v Lord Ashburton* [1914] AC 932 (HL) 954 (Viscount Haldane LC).
[92] In *Armitage v Nurse* [1998] Ch 241 (CA) 260, Millett LJ also came to this conclusion, though he did so by reference to case-law on s 26 of the Limitation Act 1939, which he mistakenly took to be the predecessor of s 21 of the 1980 Act. In fact, s 19 of the 1939 Act was replaced by s 21 of the 1980 Act, and s 26 of the 1939 Act was succeeded by s 32 of the 1980 Act.
[93] Page 334 above.

investing. He must not make investments which are not authorized by the trust deed or allowed by the general law. This liability is strict. If a trustee pays the wrong person because of a totally innocent mistake or after taking legal advice, he still has to restore the fund. If he makes an unauthorized investment, the beneficiaries can recognise and adopt it[94] or treat it as made out of the trustee's own money and require the authorized investment to be put back in place.

What limitation period applies to such claims? As to claims against the trustees for breach of trust in paying the wrong beneficiaries, the same rules will undoubtably apply as those just discussed with respect to failure properly to invest. The position regarding unauthorized investments is more difficult. A typical case is *Foskett v McKeown*,[95] where a trustee used a combination of his own funds and trust funds to purchase a life insurance policy on his own life. The House of Lords held that the beneficiaries of the trust had a pro rata share in the money paid out under the policy when the trustee took his own life. A claim such as that made in *Foskett* might be seen as an action "to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee" and therefore exempted by both section 21(1)(b) and the rules of laches from any period of limitation.

But the question is not easy, for the House of Lords in *Foskett v McKeown* failed to tell us why the right to the unauthorized investment arose. If it did so through an event within the series "unjust enrichment"[96] or an event within the series "wrongs"[97] (breach of trust), then it is hard to see why the equivalent limitation periods for personal responses to those claims should not also apply here. But a word of caution needs to be sounded. It is not only trustees who will hold substitute assets on trust for the owners of the original thing. Non-trustees, such as the defendant in *Taylor v Plumer*[98] might do so as well. Adopting the narrow view of breach of trust discussed above, such claims to substituted assets, even where that substitution is effected by a trustee, will not be seen as claims generated by the event of breach of trust. But others would say that even taking the wider view, the event here is generically different to breach of trust in that we are not even talking of "wrongs." It should also be noted that the type of trust which arises in a case like *Foskett v McKeown* is a constructive trust, and we have already seen that the exemption from laches only applies to express trusts[99] and the argument that the operation of section 21 should be similarly confined.[100]

94 *Re Jenkin's & Randall's Contract* [1903] 2 Ch 362; *Wright v Morgan* [1926] AC 788 (PC).

95 *Foskett v McKeown* [2001] AC 102 (HL).

96 Professor Birks would say that the specific unjust factor here is "ignorance": P Birks, "Property, Unjust Enrichment, and Tracing" (2001) 54 CLP 231, 246–247.

97 Beyond consent, wrongs, and unjust enrichment there is a fourth, miscellaneous, category. It might be argued that the event of substitution belongs here, and not in any of the three nominate categories. Exactly what limitation period would then apply is difficult to say.

98 (1815) 3 M & S 352, 105 ER 721.

99 Text to nn 48–55 above.

100 Pp 333–334 above.

## 4 The Obligation to Act Disinterestedly

The obligation to act disinterestedly is often described as an obligation not to profit from the trust. When we ask which profits are prohibited, in nearly every case the answer is given by the rule against conflicts of interest. The trustee is under an obligation not to pursue an interest which conflicts or might conflict with his duty to the beneficiaries. The rigour of this obligation is expressed in the hypothetical nature of the inquiry. The question is not whether his pursuit of a given interest did influence him to sacrifice the interests of the beneficiaries or did tempt him to do so but whether it might possibly have tempted the trustee to sacrifice their interests.[101]

The liability here is one which is a species of restitution for wrongdoing, the wrong being a breach of fiduciary duty. Adopting the wider view adumbrated above,[102] but not otherwise, that breach of fiduciary duty would also amount to a breach of trust. There is then a great debate as to the nature of the response in such cases. If the profit consists of some personal or proprietary right,[103] is the value of that right merely owed to the beneficiaries,[104] or is it also held for them on trust?[105] If the claim is only personal, then, at least in the case of an innocent breach,[106] it might be seen to fall within section 21(3) and so barred after the expiration of six years from the date of enrichment. Where the breach is fraudulent, again, as discussed above,[107] the normal rule in section 21(3) should only be ousted if the fraud involved a concealment of the cause of action, in which case the claim should then be subject to the doctrine of laches. If, however, we go down the proprietary route, a completely different picture emerges, for now the beneficiary can rely on section 21(1) to say that theirs is a claim to recover from the trustee trust property to which (laches apart) no limitation period applies. That problem is of course avoided if the whole idea of a proprietary right being generated by the wrong of breach of fiduciary duty is rejected. A less radical solution would be to say that section 21(1) only applies to express trusts, and that the trusts here are unequivocally constructive.

We have already noticed the debate as to whether all breaches of equitable obligations by trustees amount to breaches of trust. A different controversy arises with the so-called "self-dealing" and "fair-dealing" rules. The "self-dealing" rule dictates that a trustee is not permitted to purchase the trust property itself, so that if he does, a beneficiary of the trust is able to set the transaction aside, no

101 *Keech v Sandford* (1726) Sel Cas Ch 61, 22 ER 629; *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134n (HL).
102 Text to nn 82–83.
103 As opposed to the provision of some service.
104 *Lister v Stubbs* (1890) 45 Ch 1 (CA).
105 *A-G for Hong Kong v Reid* [1994] 1 AC 324 (PC). This is not the place to enter that debate. The better view is that the claim is only personal: see the persuasive arugment of D Crilley "A Case of Proprietary Overkill" [1994] RLR 57.
106 As, for example, in *Keech v Sandford* (1726) Sel Case Ch 61, 22 ER 629.
107 Text to nn 90–93 above.

matter how fair it might have been.[108] The "fair-dealing" rule, by contrast, provides that the purchase of a beneficial interest in a trust will be upheld, but only if the trustee shows that he obtained no advantage by reason of his position as trustee.[109] In *Tito v Waddell (No 2)*[110] Megarry V-C held (obiter) that breaches of these rules were not breaches of trust at all; the trustees were instead under a disability in dealing with the particular assets. "What equity does", he said, "is to subject trustees to particular disabilities in cases falling within the self-dealing and fair-dealing rules." Those textbooks which classified breach of the "self-dealing" and "fair-dealing" rules as breaches of trust were "wrong."[111] If this is right, then we have moved out of wrongs altogether and into unjust enrichment, with breaches of the "self-dealing" and "fair-dealing" rules providing non-wrongful reasons (unjust factors) for the return of the enrichment. In this respect, they are similar to undue influence, though it has to be admitted that some,[112] wrongly,[113] also describe this as a wrong. And it has to be admitted that Megarry J himself described infringements of these rules as breaches of fiduciary duty.[114] But either way, it would seem that breach of the "self-dealing" or "fair-dealing" rules are not breaches of trust.

## C CLAIMS AGAINST THIRD PARTIES

Third parties may also incur liabilities towards the beneficiaries in respect of breaches of trust by trustees. Most importantly, they may be liable for assisting a trustee to commit a breach of trust, and in respect of any receipt by them of rights dissipated in breach of trust.

### 1 Assistance Claims

Where a third party is held liable for assisting a breach of trust, that person comes under a liability either to compensate the beneficiary for his loss or to make restitution to the beneficiary of the third party's gains.[115] In a rational world we would call this a liability to pay damages, either compensatory or restitutionary, for the wrong of assisting a breach of trust. Unfortunately, we do not live in such a world, though there are signs that we are moving in that

[108] *Campbell v Walker* (1800) 5 Ves 867, 31 ER 801; *ex p Lacey* (1802) 6 Ves 625, 31 ER 1228.
[109] *Coles v Trecothick* (1804) 9 Ves 234, 32 ER 529; *Morse v Royal* (1806) 12 Ves 355, 33 ER 134; *Chalmer v Bradley* (1819) 1 J & W 51, 37 ER 294.
[110] [1977] Ch 106.
[111] *Tito v Waddell (No 2)* (n 110 above) 248.
[112] For example, Lord Browne-Wilkinson in *Barclay's Bank plc v O'Brien* [1994] 1 AC 180 (HL) 191, 196, 198.
[113] See the argument of Birks in P Birks "Notice and Onus in *O'Brien*" (1998) 12 TLI 2.
[114] [1977] Ch 106, 250.
[115] For the conditions of liability, see *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 AC 378 (PC).

direction.[116] Instead of speaking of damages for wrongdoing, the courts couch the liability in terms of the assister "accounting as a constructive trustee." We have already seen how the Limitation Act 1980 defines "trustee" to include "constructive" trustees. Would a claim for assistance therefore come within the six-year period laid down by section 21(3)?

Looking at the legislative history of section 21(3), it would appear that such claims do not fall within its purview. As we have seen, section 21(3) ultimately derives from section 8(1)(b) of the Trustee Act 1888, which enacted a six-year time limit for claims against express trustees for compensation for innocent breaches of trust. And though the definition of "trustee" in the 1888 Act also included "constructive" trustees, there is no reason why section 8(1)(b) should extend to non-trustees. Although the assister is liable to account *as if he were* a trustee, we know that this is only a device to bring him within the jurisdiction of the court. As Millett LJ recently pointed out in *Paragon Finance plc v D B Thakerar & Co (a firm)*,[117] he is in no sense a real trustee. Moreover, we have seen that the reason why the legislature in 1888 introduced an extended meaning of trustee was to enact the "no side-stepping" rule contained in section 8(1)(a). Indeed, with that rule now rendered redundant by the recasting of limitation statutes in terms of causes rather than forms of action, we have seen that the wide definition of trustee used in the 1939 and 1980 Acts is no longer needed, and a limitation to express trustees could profitably be restored.

With section 21(3) out of the way, no other limitation period is laid down by the statute, and since this is a case within equity's exclusive jurisdiction, so that there is no period which might be applied by analogy, the conclusion must be that such claims are subject only to the doctrine of laches.

## 2 Receipt Claims

We are concerned for the moment only with personal claims against recipients. This is not the place to enter into the debate about whether personal claims against recipients of trust property dissipated in breach of trust are strict or fault-based, for the answer will make no difference to the law of limitation of claims against them. In either case, the limitation period here will be the same as that described above for assistance claims, the "constructive trusteeship" of the recipient arising in precisely the same way as that of the assister.[118]

[116] In a recent conflict of laws decision, the liability here discussed was classified by the Court of Appeal as a matter relating to a "tort, delict or quasi-delict": *Casio Computer Co Ltd v Sayo* [2001] EWCA Civ 661.

[117] [1999] 1 All ER 400 (CA), 409.

[118] Though the recent decision of Jonathan Parker J in *Bank of Credit and Commerce International v Jan* (Ch D, 17 November 1999) is to the contrary, none of the arguments made in this paper were put to the judge.

### 3 Claims for the Return of the Trust Assets or their Traceable Substitutes

Where the recipient has dissipated the trust fund, the beneficiary's only hope, apart from a personal claim against the wrongdoing trustee, is a personal claim against the recipient. But where the asset itself or its traceable proceeds is still in the recipient's hands, a proprietary claim will be available to the beneficiary, so long of course as the recipient was not a purchaser for value of the legal title to the asset without actual or constructive notice of the dissipation in breach of trust.[119] Absent this defence, the claim is undoubtably a strict liability claim.[120] What period of limitation will apply to it?

We have already seen how claims against express trustees for the delivery up of the trust assets have always been exempted from the operation of statutes of limitation and from the doctrine of laches. But our recipient will not be an express trustee, where that term is used to mean a trustee appointed by the trust instrument, but a constructive trustee, made so simply by the rules of priorities. As such, he will not be under the same duties as would an express trustee, eg, to invest, to refrain from entering into conflicts of interest, and so on. In truth, he is not really a trustee at all.[121] But as we know, the word "trustee" in the 1980 Act includes a constructive trustee. The question then is whether this sort of claim is one which comes within section 21(1). The answer is that, considering the legislative history of section 21(1), it is not. As we have seen, section 21(1) is the successor to section 19(1) of the 1939 Act, which in turn succeeded section 8 of the Trustee Act 1888.[122] We have also seen that section 8 was intended to preserve the rule that limitation periods in equity never applied to claims against express trustees, and that the wider definition of trustee as including constructive trustees was only brought in for the purposes of section 8(1)(b), a provision which is not replicated, for reasons already explained, in either the 1939 or 1980 Acts. The upshot, therefore, is that the word "trustee" in section 21(1) should be confined to express trustees.

But if section 21(1) does not apply, could it not be argued that the claim is caught by the six-year period laid down in section 21(3)? Is this not, after all, "an action by a beneficiary to recover trust property"? The answer is that the section cannot mean what it says, and though it appears to refer to proprietary claims, it in fact means only personal claims. We have already seen that this was the only sensible construction which could have been made of section 8(1)(b) of the 1888 Act,[123] and section 21(3) is the successor in title to that provision. With neither sections 21(1) or 21(3) applying, we are then thrown back on the equitable doctrine of laches.

[119] *Pilcher v Rawlins* (1872) LR 7 Ch App 250 (CA).
[120] *Re Montagu's Settlement Trust* [1987] Ch 264.
[121] Brunyate described such trusts as "fictional": J M Brunyate, *Limitation in Equity* (CUP Cambridge 1932) 57.
[122] Text to nn 65–66 above.
[123] Text to nn 67–68 above.

## D CONCLUSION

The current limitation régime for breach of trust is a mess. The statutory enactments are impossible to understand unless each provision is traced all the way back to its origins. Once that is done, it can be seen that, somewhat surprisingly, the 1980 Act applies to only one species of claim in this area, viz the claim against an express trustee for innocent breach of trust generating a personal claim to compensation. As regards the other possible claims, all bar one are governed by the doctrine of laches. The exception is the claim by a beneficiary to have conveyed to him or her the rights held by an express trustee under an express trust, to which neither a statutory limitation period nor the doctrine of laches applies.

## APPENDIX I

### Extract from the Limitation Act 1540

*FORASMUCH as the time of limitation appointed for suing of writs of right, and other writs of possession and seisin of mens ancestors or predecessors, or of their own possession or seisin, by the laws and statutes of this realm heretofore made, limited and appointed, extend, and be of so far and long time past, that it is above the remembrance of any living man, truly to try and know the perfect certainty of such things, as hath or shall come in trial, or do extend unto the time and times limited by the said laws and statutes, to the great danger of mens consciences that have or shall be impanelled in any jury for the trial of the same; (2) and it is also a great occasion of much trouble, vexation and suits to the King's loving subjects at the common laws of this realm; so that no man, although he and his ancestors, and those whose estate he or they have, have been in peaceable possession of a long season, of and in lands, tenements and other hereditaments, is or can be in any surety, quietness or rest, of and in the same, without a good remedy and reformation be had, made and provided for the same:* (3) be it therefore enacted . . ., That no manner of person or persons shall from henceforth sue, have or maintain any writ of right, (4) or make any prescription, title or claim of, to or for any manors, lands, tenements, rents, annuities, commons, pensions, portions, corrodies or other hereditaments, (5) of the possession of his or their ancestor or predecessor, and declare and alledge any further seisin or possession of his or their ancestor or predecessor, but only of the seisin or possession of his ancestor or predecessor, which hath been, or now is, or shall be seised of the said manors, lands, tenements, rents, annuities, commons, pensions, portions, corrodies or other hereditaments, within threescore years next before the *teste* of the same writ, or next before the said prescription, title or claim so hereafter to be sued, commenced, brought, made or had.

II. And be it further enacted . . ., That no manner of person nor persons shall hereafter sue, have or maintain any assise of mort-ancestor . . . within fifty years next before the *teste* of the original of the same writ hereafter to be brought.

## APPENDIX II

### Extract from the Limitation Act 1623

**1** For quieting of mens' estates, and avoiding of suits, be it enacted . . ., That all writs of *formedon in descender, formedon in remainder,* and *formedon in reverter*, at any time hereafter to be sued or brought, of or for any manors, land, tenements or hereditaments . . . shall be sued and taken within twenty years next after the end of this present session of parliament; and after the said twenty years expired, no such person or persons, or any of their heirs, shall have or maintain any such writ, of or for any of the said manors, lands, tenements or hereditaments; . . .

**3** And be it further enacted, That all actions of trespass *quare clausum fregit*, all actions of trespass, detinue, action sur trover, and replevin for taking away of goods and cattle, all actions of account, and upon the case, other than such accounts as concern the trade of merchandize between merchant and merchant, their factors or servants, all actions of debt grounded upon any lending or contract without specialty; all actions of debt for arrearages of rent, and all actions of assault, menace, battery, wounding and imprisonment, or any of them shall be sued or brought at any time after the end of this present session of parliament, shall be commenced and sued within the time and limitation hereafter expressed, and not after (that is to say) (2) the said actions upon the case (other than for slander) and the said actions for account, and the said actions for trespass, debt, detinue and replevin for goods or cattle, and the said action of trespass *quare clausum fregit*, within three years next after the end of this present session of parliament, or within six years next after the cause of such actions or suit, and not after; (3) and the said actions of trespass, of assault, battery, wounding, imprisonment or any of them, within one year next after the end of this present session of parliament, or within four years next after the cause of such actions or suit, and not after; (4) and the said actions upon the case for words, within one year after the end of this present session of parliament, or within two years next after the words spoken, and not after.

## APPENDIX III

### Extract from the Real Property Limitation Act 1833

**24** And be it further enacted, That after the said Thirty-first Day of *December* One thousand eight hundred and thirty-three no Person claiming any Land or Rent in Equity shall bring any Suit to recover the same but within the Period during which by virtue of the Provisions herein-before contained he might have made an Entry or Distress or brought an Action to recover the same respectively if he had been entitled at Law to such Estate, Interest, or Right in or to the same as he shall claim therein in Equity.

**25** Provided always, and be it further enacted, That when any Land or Rent shall be vested in a Trustee upon any express Trust, the Right of the Cestuique Trust, or any Person claiming through him, to bring a Suit against the Trustee, or any Person claiming through him, to recover such Land or Rent, shall be deemed to have first accrued, according to the Meaning of this Act, at and not before the Time at which such Land or Rent shall have been conveyed to a Purchaser for a valuable Consideration, and shall then be deemed to have accrued only as against such Purchaser and any Person claiming through him.

**26** And be it further enacted, That in every Case of concealed Fraud the Right of any Person to bring a Suit in Equity for the Recovery of any Land or Rent of which he, or any Person through whom he claims, may have been deprived by such Fraud, shall be deemed to have first accrued at and not before the Time at which such Fraud shall or with reasonable diligence might have been first known or discovered; provided that nothing in this Clause contained shall enable an Owner of Land or Rents to have a Suit in Equity for the Recovery of such Lands or Rents on account of Fraud, against any *bona fide* Purchaser for valuable Consideration who has not assisted in the Commission of such Fraud, and who at the Time that he made the Purchase did not know and had no Reason to believe that any such Fraud had been committed.

**27** Provided always, and be it further enacted, That nothing in this Act contained shall be deemed to interfere with any Rule or Jurisdiction of Courts of Equity in refusing Relief on the Ground of Acquiescence or otherwise to any Person whose Right to bring a Suit may not be barred by virtue of this Act.

## APPENDIX IV

### Extract from the Trustee Act 1888

**1** (3) For the purposes of this Act the expression "trustee" shall be deemed to include an executor or administrator and a trustee whose trust arises by construction or implication of law as well as an express trustee.

**8** (1) In any action or other proceeding against a trustee or any person claiming through him, except where the claim is founded upon any fraud or fraudulent breach of trust to which the trustee was party or privy, or is to recover trust property, or the proceeds thereof still retained by the trustee, or previously received by the trustee and converted to his use, the following provisions shall apply:-

(a) All rights and privileges conferred by any statute of limitations shall be enjoyed in the like manner and to the like extent as they would have been enjoyed in such action or other proceeding if the trustee or person claiming through him had not been a trustee or person claiming through him;

(b) If the action or other proceeding is brought to recover money or other property, and is one to which no existing statute of limitations applies, the trustee or person claiming through him shall be entitled to the benefit of and be at liberty to plead the lapse of time as a bar to such action or other proceeding in the like manner and to the like extent as if the claim had been against him in an action of debt for money had and received, but so nevertheless that the statute shall run against a married woman entitled in possession for her separate use, whether with or without a restraint upon anticipation, but shall not begin to run against any beneficiary unless and until the interest of such beneficiary shall be an interest in possession.

## APPENDIX V

### Extract from the Limitation Act 1939

**2** (1) The following actions shall not be brought after the expiration of six years from the date on which the cause of action accrued, that is to say:-

(a) actions founded on simple contract or tort;

. . .

(2) An action for an account shall not be brought in respect of any matter which arose more than six years before the commencement of the action.

(7) This section shall not apply to any claim for specific performance of a contract or for an injunction or for other equitable relief, except in so far as any provision thereof may be applied by the Court by analogy in like manner as the corresponding enactment repealed by this Act has heretofore been applied.

**19** (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action-

(a) in respect of fraud or any fraudulent breach of trust to which the trustee was a party or privy; or

(b) to recover from the trustee trust property or the proceeds thereof in the possession of the trustee, or previously received by the trustee and converted to his use.

(2) Subject as aforesaid, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued . . .

**26** Where, in the case of any action for which a period of limitation is prescribed by this Act, either -

(a) the action is based upon fraud of the defendant or his agent or of any person through whom he claims or his agent, or

(b) the right of action is concealed by the fraud of any such person as aforesaid, or

(c) the action is for relief from the consequences of a mistake,

the period of limitation shall not begin to run until the plaintiff has discovered the fraud or the mistake, as the case may be, or could with reasonable diligence have discovered it . . .

**31** (1) In this Act, unless the context otherwise requires,the following expressions have the meanings respectively assigned to them:-

"Trust" and "trustee" have the same meanings respectively as in the Trustee Act, 1925;

## APPENDIX VI

### Extract from the Limitation Act 1980

**21** (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action-

(a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
(b) to recover from the trustee trust property or the proceeds of trust property in the possession of the trustee, or previously received by the trustee and converted to his use.

(3) Subject to the preceding provisions of this section, an action by a beneficiary to recover trust property or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by any other provision of this Act, shall not be brought after the expiration of six years from the date on which the right of action accrued.

**23** An action for an account shall not be brought after the expiration of any time limit under this Act which is applicable to the claim which is the basis of the duty to account.

**32** . . . where in the case of any action for which a period of limitation is prescribed by this Act, either -

(a) the action is based upon the fraud of the defendant; or
(b) any fact relevant to the plaintiff's right of action has been deliberately concealed from him by the defendant; or
(c) the action is for relief from the consequences of a mistake;

the period of limitation shall not begin to run until the plaintiff has discovered the fraud, concealment or the mistake (as the case may be) or could with reasonable diligence have discovered it.

**36** (1) The following time limits under this Act, that is to say -

(a) the time limit under section 2 for actions founded on tort;
(b) the time limit under section 5 for actions founded on simple contract;
. . .

shall not apply to any claim for specific performance of a contract or for an injunction or for other equitable relief, except in so far as any such time limit may be applied by the court by analogy in like manner as the corresponding time limit under any enactment repealed by the Limitation Act 1939 was applied before 1st July 1940.

(2) Nothing in this Act shall affect any equitable jurisdiction to refuse relief on the ground of acquiesence or otherwise.

**38** (1) In this Act, unless the context otherwise requires-

"trust" and "trustee" have the same meanings respectively as in the Trustee Act 1925.

# 12

# *Laches, Estoppel and Election*

GARY WATT

WHERE CIVIL LITIGATION is contentious it is a competition not only between the parties to the particular cause but also between their private interests and the interests of the public at large, for it is of the essence of litigation that private disputes are conducted in the public domain and in part at public expense. Even non-contentious litigation of a kind common in relation to trusts uses up publicly provided resources. The Civil Procedure Rules 1998 acknowledge this inasmuch as they recognize that the "overriding objective of enabling the court to deal with cases justly" requires courts to ensure that each case is "dealt with expeditiously and fairly" and that no more than "an appropriate share of the court's resources" is allotted to it.[1] The need to strike an appropriate balance between private and public interests is also implicit in Article 6 of the European Convention on Human Rights,[2] which provides that "in the determination of his civil rights and obligations . . . everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law." Unless the judicial system encourages the avoidance, expedition and conclusion of litigation in particular cases, it will become overburdened and unable to provide the resources necessary to meet the general demand for prompt and fair hearings.

The competition between public and private interests is played out in numerous doctrines of civil procedure, three of which, laches, cause of action estoppel and election, have been selected for consideration here on account of their special relevance to litigation arising from breach of trust. Orthodox "cause of action estoppel" is a procedural bar which prevents the relitigation of a cause which has already proceeded to final judgment. Used in a less technical sense "cause of action estoppel" can also describe the procedural bar which prevents a claimant from litigating a cause which should have been—*but was not in*

[1] SI No 3132 rule 1.1(1), (2).

[2] *The Convention for the Protection of Human Rights and Fundamental Freedoms* (Rome, 4 November 1950; TS 71 (1953); Cmd. 8969). S 6 of the Human Rights Act 1998 requires courts, as "public bodies," to give effect to the provisions of the Convention.

*fact*—raised as part of an earlier (now concluded)[3] civil action brought by the same claimant and arising from substantially the same factual matter.

This study will focus on the latter, wider form of "cause of action estoppel," which the courts nowadays consider to be a branch of the doctrine of abuse of process.[4] It might operate, for example, where a trust beneficiary, having settled a claim for breach of trust against a corporate trustee, issues further proceedings against the directors of the corporate trustee on account of their dishonest assistance in the same breach of trust.[5] The fact that the *defendants* are sued in different capacities does not necessarily exclude the operation of the procedural bar if, taking all the facts into consideration, the later action was an abuse of process.[6] Indeed, the bar might even be raised where the *claimants* in the successive actions are different legal persons, if one is the privy of the other.[7]

This Chapter identifies certain doctrinal and functional similarities between laches, election, and the "wide" form of cause of action estoppel.[8] Such observations are, however, incidental to the main aim which is to demonstrate that the proper application of these doctrines to litigation arising from breach of trust requires due weight to be attached to both private and public interests. I will submit that the modern judicial approach to these doctrines sometimes fails to identify public interests relevant to their operation and, where relevant public interests are identified, sometimes fails to achieve an appropriate balance. The significance of the public interest in civil procedure should never be underestimated, for it will sometimes require that the mouth of truth be taped up.[9]

## A LACHES

### 1 The Scope of the Doctrine

On the 9 July 2001, the Law Commission for England and Wales published a report on the Limitation of Actions,[10] accompanied by a new Limitation Bill.

[3] Whether by judgment or settlement: *Johnson v Gore Wood* [2001] 2 WLR 72 (HL) 91H.

[4] *Johnson v Gore Wood* (n 3 above) 90A.

[5] Although, if the directors of the corporate trustee had settled the action against the corporate trustee on the understanding that there would be further litigation against the directors personally, the directors would be estopped by their representation from pleading cause of action estoppel.

[6] *Manson v Vooght* [1999] BPIR 376, 387 (May LJ).

[7] This possibility was acknowledged in *Johnson v Gore Wood* (n 3 above).

[8] Such similarities should not be overstated. Certainly, the suggestion that laches, election and estoppel may be categorized as species of waiver (Lord Wright in *Smyth & Co v Bailey & Co* [1940] 3 All ER 60 (HL) 70 and Brennan J in *Commonwealth v Verwayen* [1990] 170 CLR 394 (HC Aus) 421) has not elucidated the doctrines, as Mason CJ and Brennan J acknowledged *Verwayen* 406, 422.

[9] "There is a fundamental principle of English law generally expressed by a Latin maxim (going back to *Coke's Commentary on Littleton*, p. 330) which can be translated: 'It is in the interest of society that there should be some end to litigation.' . . . Truth may be thus shut out; but society considers that truth may be bought at too high a price, that truth bought at such expense is the negation of justice." The *Ampthill Peerage* [1977] AC 547 (HL Committee For Privileges) 575G-H (Lord Wilberforce).

[10] *Limitation of Actions* Law Com No. 270 (HMSO London 2001).

The implications of these reforms are considered later, but at the time of writing the Bill has not yet passed into law. The present situation is that certain cases are excepted from the statutory six-year limitation period which ordinarily applies to "an action by a beneficiary to recover trust property or in respect of any breach of trust."[11] Instances excepted by the statute itself include cases of "fraud or fraudulent breach of trust to which the trustee was a party or privy"[12] and cases where trust property, the proceeds of trust property, or notional trust property,[13] are still in the possession of the trustee or have been converted to the trustee's use.[14] A further exception, recognized by the courts, is breach of the "self-dealing" and "fair-dealing" rules.[15] These rules are of special relevance to this study because of their concern for the public interest in "fiduciary propriety."[16] The rule against self-dealing is particularly significant because it requires that a trustee's purchase of trust-owned assets must be set aside *ex debito justitiae*,[17] at the instance of a beneficiary, irrespective of proof that the transaction was entirely fair (or even generous) to the party seeking to have it set aside.[18]

Any cause of action which is expressly subject to a statutory period of limitation cannot be subject to the doctrine of laches,[19] but laches is applicable to those situations, outlined in the preceding paragraph, which are excepted from the statutory period. Even "gross breaches of trust"[20] and cases where fraud is alleged against the trustee might eventually be barred by laches.[21] What is more,

[11] Limitation Act 1980 s 21(3). Proposals for reform are considered below.

[12] Limitation Act 1980 ss 21(1)(a) and 32 (1)(a). *Armitage v Nurse* [1998] Ch 241 (CA) held that proof of actual dishonesty was required to establish "fraud" under s21(a). But see GH Jones (ed) *Goff & Jones, The Law of Restitution* (5th edn Sweet & Maxwell London 1998) 858.

[13] *Re Howlett* [1949] 2 All ER 490 illustrates how notional trust property can be said to remain in the possession of the trustee.

[14] Limitation Act 1980 s 21(1)(b). See *Nelson v Rye* [1996] 1 WLR 1378.

[15] *Tito v Waddell* (No2) [1977] Ch 106, 248–249 (Megarry V-C).

[16] Numerous cases testify to the public interest in fiduciary propriety. In *Lloyds Bank Ltd v Bundy* [1975] QB 326 (CA) Sir Eric Sachs held that once a fiduciary duty is established it is "contrary to public policy that the benefit of the transaction be retained by the person under the duty unless he positively shows that the duty of fiduciary care has been fulfilled" (346B); and in *Goldsworthy v Brickell* [1987] 2 WLR 133 (CA) Nourse LJ stated that "[a] relationship wherein one party has ceded . . . a degree of trust and confidence" might "require the other, on grounds of public policy, to show that it has not been betrayed or abused"(150B). Cf *Parker v McKenna* (1874) 10 Ch App 96 (CA)125 (James LJ); *Regal (Hastings) Ltd v Gulliver* (1942) [1967] 2 AC 134n (HL) 157B; Law Commission Consultation Paper 151 (1998), *The Limitation of Actions*, para. 13.100; Law Reform Committee, *Twenty-First Report (Final Report on Limitation of Actions)* (1977) Cmnd 6923 para. 3.82.

[17] See *Tito v Waddell* (n 15 above) 241A-B.

[18] See, generally, Hon Mr Justice B H McPherson "Self-dealing Trustees" in A J Oakley (ed) *Trends in Contemporary Trust Law* (Clarendon Press Oxford 1996) 47.

[19] *Re Pauling's Settlement Trusts* [1962] 1 WLR 86, 115 (Wilberforce J) aff'd [1964] Ch 303 (CA).

[20] *Harcourt v White* (1860) 28 Beav 303, 310 (Sir John Romilly).

[21] "[A] sufficient time should bar any suit however much fraud and concealment was practiced by the original wrongdoer" J Brunyate *Limitation of Actions in Equity* (CUP Cambridge 1932) 192. "Even in cases of fraud relief will be refused after a long lapse of time, especially when sought against successors by operation of law, or innocent persons claiming under the fraudulent party" Michael Franks *Limitation of Actions* (Sweet & Maxwell London 1959) 238. When, in *Armitage v Nurse* (n 12 above) Millett LJ said that "liability for a dishonest breach of trust endures without limitation of time" (719g), his Lordship was referring to statutory limitation.

in cases not expressly subject to a statutory period "[c]ourts of Equity have constantly guided themselves by the principle that, wherever the legislature has limited a period for law proceedings, equity will, in analogous cases, consider the equitable rights as bound by the same limitation."[22] Whether such application of the statutory period by analogy is an aspect of the doctrine of laches or an instance, distinct from the doctrine of laches, of equity's tendency to follow the common law is a moot point.[23] It is clear, however, that laches can be pleaded in actions for breach of trust where the defendant trustee has committed fraud or is still holding trust property and in cases where the "self-dealing" and "fair-dealing" rules have been breached. However, *cases where there has been no breach of trust*,[24] are not contemplated by the Limitation Act 1980. In such cases, whereas a claim to assert proprietary rights under a constructive trust[25] might be barred by laches,[26] a beneficiary's claim to recover property from the trustee of an express trust will not be.[27]

[22] *Hovenden v Annesley* (1806) 2 Sch & Lef 607, 632 (Lord Redesdale). See, also, *Cholmondeley v Clinton* (1820) 2 Jac & W 1, 149; *Paragon Finance Plc v D B Thakerar & Co* [1999] 1 All ER 400 (CA) 415h; and *Companhia De Seguros Imperio (A Body Corporate) v Heath (Rebx) Ltd (Formerly Ce Heath & Co (North America) Ltd) & Ors* [2001] 1 WLR 112. Equity's practice of applying time limits by analogy is expressly preserved by s 36 of the Limitation Act 1980. When applying the statutory period by analogy, equity acts "on the ground that Parliament has shown the public policy that should be followed" *Attorney-General v Cocke* [1988] 2 WLR 542, 545C(Harman J).

[23] The application of the statute by analogy has been contrasted with situations where "the doctrine of laches alone applies": Franks (n 21 above) 233, but see Brunyate (n 21 above) who suggested that "[w]hen . . . the Court acts by analogy to the statute it adopts the statutory period as part of the law of laches"(257).

[24] "Lapse of time and acquiescence apply to cases where a fund is parted with or becomes deficient, and where you seek to make a trustee answerable or liable to pay something by reason of his conduct" *Mills v Drewitt* (1855) 20 Beav 632, 638 (Sir John Romilly MR).

[25] I do not include, within the description "constructive trust," situations where the defendant "receives the trust property . . . adversely to the plaintiff by an unlawful transaction which is impugned by the plaintiff." For as Millett LJ observed in *Paragon* (n 22 above) in such cases there is in truth no breach of trust, but merely a breach of some other duty in response to which equity imposes a form of "constructive trusteeship." Banning warned that "not everything which is called a trust is a trust": A Brown (ed) *Banning's Law on the Limitation of Actions* (3rd edn Stevens and Haynes Temple Bar 1906) 180). See M Hemsworth "*Constructive Trusts and Constructive Trustees—What's in a Name?*: *Section 21 of the Limitation Act 1980*" (2000) 19 Civil Justice Quarterly 154–167.

[26] "A claim to establish a constructive trust is one which calls for promptitude, and is liable to be barred on the ground of acquiescence, or by delay alone": J M Lightwood *The Time Limit on Actions—A Treatise on the Statute of Limitations and the Equitable Doctrine of Laches* (Butterworths London 1909) 268. But contrast J Weeks QC (ed) *Preston and Newsom's Limitation of Actions* (4th edn Longman London 1989) 49: "[i]ndefinite liability probably applies even when there is no pre-existing trust relationship and the trusteeship arises out of the act complained of: *Shephard v Cartwright* [1955] AC 431, 450." Weeks does acknowledge that there is Privy Council authority against him on the point *Taylor v Davies* [1920] AC 636(PC) and *Clarkson v Davies* [1923] AC 100 (PC).

[27] Franks (n 21 above) 260–261. *Rochefoucauld v Boustead* [1897] 1 Ch 196 (CA) 212. According to Sir W Page Wood in *Re Ashwell's Will* (1859) Johns 112, 117, laches does not apply where the fund which is the subject of the claim has never been applied in any way, but is still in the hands of trustees. *See, also, Wedderburn v Wedderburn* (1838) 4 My & Cr 41, where Cottenham LC said that a direct trust "of which the transactions are not closed" must be distinguished from "an attempt to raise a constructive trust upon transactions closed many years before"(53).

> It is certainly true that no time bars a direct trust as between cestui que trust and trustee; but if it is meant to be asserted that a Court of Equity allows a man to make out a case of constructive trust at any distance of time after the facts and circumstances happened out of which it arises, I am not aware that there is any ground for a doctrine so fatal to the security of property as that would be; so far from it, that [even] where it is perfectly clear that relief would originally have been given on the ground of constructive trust, it is refused to the party who after long acquiescence comes into a Court of Equity to seek that relief.[28]

"The rules which govern cases of direct trust . . . do not equally apply to cases of constructive trust."[29] However, if a trustee informs the cestui que trust of an intended mode of distribution of the trust fund (under, say, a discretionary trust) the beneficiary may come under a duty to make any objection promptly,[30] and on the final distribution bringing a trust to an end it is likely that laches will more readily be raised to bar subsequent claims against the trustee.

There are at least two possible reasons why laches does not apply to express trusts which have not been breached. The first reason, which is based on *inter partes* considerations, is the absence in such cases of the special evidential difficulties which accompany claims when the trust is *not* expressed or admitted. When the trust is not expressed or admitted the volume (and perhaps the complexity) of the contested evidence will generally be greater, and the greater therefore will be the prejudice caused to the defendant by the passage of time.[31] The second justification for the distinction flows from the public interest in fiduciary propriety. Where a trust is expressed or admitted it is more likely to be in the public domain. Certainly this will be the case where the trustee is a public trustee, judicial trustee, charity trustee, trustee in bankruptcy, an executor or a corporate or professional trustee which advertises its services as such. If judicial insistence upon "fiduciary propriety" is to achieve any of its symbolic and prophylactic (including deterrent) aims, persons who are known to be trustees cannot be permitted to plead laches in circumstances where pleading such would amount to a denial of their trust.[32]

## 2 Laches and the Public Interest

According to Sir Barnes Peacock, delivering the advice of the Privy Council in *Lindsay Petroleum Company v Hurd*:[33]

> The doctrine of laches in Courts of Equity is not an arbitrary or a technical doctrine. Where it would be practically unjust to give a remedy, either because the party has, by

[28] *Beckford v Wade* (1810) 17 Ves 87, 97 (Grant MR).
[29] *Clegg v Edmondson* 8 De G M & G 787, 808 (Turner LJ)
[30] Brunyate (n 21 above) 239.
[31] Brunyate (n 21 above) 234. *AG v Fishmongers' Co* (1841) 5 Myl & Cr 16; *Beckford v Wade* (n 28 above).
[32] *Burdick v Garrick* (1870) LR 5 Ch App 233 (HL) 243.
[33] (1874) LR 5 PC 221, 229.

his conduct done that which might fairly be regarded as equivalent to a waiver of it, or where, by his conduct and neglect he has, though perhaps not waiving that remedy, yet put the other party in a situation in which it would not be reasonable to place him if the remedy were afterwards to be asserted, in either of these cases, lapse of time and delay are most material. But in every case, if any argument against relief, which otherwise would be just, is founded upon mere delay, that delay of course not amounting to a bar by any statute of limitations, the validity of that defence must be tried upon principles substantially equitable. Two circumstances always important in such cases are the length of the delay and the nature of the acts done during the interval, which might affect either party and cause a balance of justice or injustice in taking the one course or the other, so far as relates to the remedy.[34]

Commenting upon this dictum in *Erlanger v New Sombrero Phosphate Co*[35], Lord Blackburn confessed that he had "looked in vain for any authority which gives a more distinct and definite rule."[36] Lord Blackburn summarized it in the following terms:

From the nature of the inquiry, it must always be a question of more or less, depending on the degree of diligence which might reasonably be required, and the degree of change which has occurred, whether the balance of justice or injustice is in favour of granting the remedy or withholding it.[37]

Michael Franks has suggested of this summary "that it is probably impossible to describe the doctrine of laches more accurately."[38] I do not agree. Perhaps Lord Blackburn, and Sir Barnes Peacock before him, took it for granted that both public and private interests must be placed in the scales when assessing the broad "balance of justice," but the tenor of their analysis suggests, rather, that the doctrine of laches is concerned exclusively with justice *inter partes*. In this respect the analysis of Lord Camden in *Smith v Clay* (1767),[39] which gives due weight to relevant public interests, is to be preferred:

A Court of Equity, which is never active in relief against conscience, or public convenience, has always refused its aid to stale demands, where the party has slept upon his right, and acquiesced for a great length of time . . . "*Expedit reipublicae ut sit finis litium*," is a maxim that has prevailed in this court in all times, without the help of an act of parliament.

Indeed, Franks himself admits, towards the conclusion of his book, that:

[a]part from the position of plaintiff and defendant the court will take into account wider considerations of the justice of granting or refusing relief and the public policy against the enforcement of "stale" demands[40] . . . The emphasis shown in the cases on inferential acquiescence on the part of the plaintiff, change of position or similar prejudice on the part of the defendant and injustice to blameless third parties suggests that

[34] *Lindsay Petroleum Company v Hurd* (n 33 above) 239–40.
[35] (1878) 3 App Cas 1218.
[36] *Erlanger v New Sombrero Phosphate Co* (n 35 above) 1279.
[37] *Erlanger v New Sombrero Phosphate Co* (n 35 above).
[38] Franks (n 21 above) 244.
[39] 3 Bro CC 639n. This note was taken from Lord Camden's own handwriting in his note book.
[40] Franks (n 21 above) 236.

mere inactivity without more cannot bar the plaintiff: and dicta to that effect are to be found . . . The true position, however, seems to be that that result, though perhaps logical, is unacceptable for practical purposes and the court will in fact reject claims after an unreasonable lapse of time even though there is no evidence or suggestion of change of position or hardship.[41]

The need to recognize laches in cases where there is no change of position, hardship, prejudice or unconscionability as between the parties themselves, arises out of laches' concern for the public interest in an end to litigation and quiescence of title (being the desire that possessory or proprietary rights which have been enjoyed peacefully for a long time should not be disturbed). This concern is apparent from the older cases, as the following dicta of Sir R P Arden MR in *Hercy v Dinwoody*[42] and *Pickering v Stamford*[43] show:

Independent of the question of satisfaction, but on account of the very neglect, and the mischief and disturbance that might arise to families . . . the laches and neglect may be such as to make it a matter of public policy that the party guilty of it shall abide by the consequences . . . Every case depends upon its particular circumstances; and the question is, whether I shall do greater public mischief (for I put it like that) by giving the account or by refusing it.[44]

The question in all these cases is, whether there are motives of public policy or private inconvenience to induce the court to say, under all the circumstances the suit ought not to be entertained; and if great public inconvenience would arise, and the stale demand would involve the parties in endless difficulties in clearing the accounts, difficulties arising from the negligence of the other parties lying by . . . [a]gainst such a bill undoubtedly the court ought to set its face.[45]

Parliament has enacted a number of statutes of limitation since Sir Richard Arden was Master of the Rolls, and this it seems has contributed to an assumption that the statutes reflect the public interest, and that laches, by default, does not apply unless there are *inter partes* considerations which call it forth.[46]

This assumption was implicit in the decision of the Court of Appeal in *Frawley v Neill*,[47] where Aldous LJ stated:

The inquiry should require a broad approach, directed to ascertaining whether it would in all the circumstances be unconscionable for a party to be permitted to assert his beneficial right. No doubt the circumstances which gave rise to a particular result in decided cases are relevant to the question whether or not it would be conscionable or unconscionable for the relief to be asserted, but each case has to be decided on its facts applying the broad approach.

[41] Franks (n 21 above) 241.
[42] (1793) 2 Ves Jun 87.
[43] (1794) 2 Ves Jun 581.
[44] Note 42 above, 93.
[45] Note 43 above 582–3.
[46] "the doctrine of laches is not operated unless one is satisfied that, to put it at its lowest, there is some prejudice to the party who is suffering from laches at the hands of the other" *Tottenham Hotspur Football & Athletic Co Ltd v Princegrove Publishers Ltd* [1974] 1 WLR 113, 122C.
[47] [2000] CP Rep 20.

It is respectfully submitted that this approach to laches, which Aldous LJ described as the "modern approach," is in fact less suited to the modern era of civil justice than the approach adopted by Sir Richard Arden more than 200 years earlier. The modern approach to laches should be one which takes into account the need to balance relevant public and private interests in the manner of its application. It is not, of course, suggested that courts should look to dispose of a case on public policy grounds where orthodox equitable doctrines can assist first. On the contrary, the efficiency of civil litigation requires certainty, and certainty dictates that recourse should first be had to established doctrines before recourse to public policy: "[p]ublic policy may truly be an unruly horse."[48] That said, certain benefits would accompany the reassertion of the public policy aspect of the doctrine of laches.

First, the need for an efficient system of justice, recently emphasized by the Civil Procedural Rules, calls for an emphasis upon the public interest in quiescence of title and an end to litigation.

Second, the issue of long delay not covered by a statutory limitation period would be brought into line with the many other issues in civil procedure which are currently resolved by reference to both public and private considerations. Examples include the amendment of pleadings,[49] dismissal for want of prosecution,[50] the "without prejudice" rule[51] and, as we shall see later, the doctrines of cause of action estoppel and election.

Third, once it is recognized that laches is in part influenced by the public interest in civil procedure, in an appropriate case countervailing public interests might be admitted to allow a stale claim to proceed even were the action would be prejudicial from a purely *inter partes* perspective. The balance of justice does not stop with the parties themselves. No doubt public policy arguments for allowing stale actions to proceed could be admitted *ad hoc*, but a more principled basis for admitting such arguments would be to recognize, first, that laches is itself, in part, a doctrine of public policy, and, second, that competing public policies must be weighed against each other when deciding whether to allow an action to proceed. It would be quite unorthodox for the court to admit a stale action when it is clear that the parties have compromised or settled the claim, but short of such a contract or some orthodox estoppel[52] or acquiescence,[53] where mere general notions of prejudice or unconscionability are relied upon by the defendant, public policy

[48] T J Reynolds "When sauce for the goose may not be sauce for the gander" (1997) 13(5) Const L J 315, 320.

[49] *Parmenter v Malt House Joinery* [1993] FSR 680.

[50] *Allen v Sir Alfred McAlpine & Sons Ltd* [1968] 2 QB229, 260 (Diplock LJ).

[51] *Unilever plc v Procter and Gamble Company* [2000] 1 WLR 2436.

[52] Such as the one in *Johnson v Gore Wood* (n 3 above) which prevented the defendant from pleading abuse of process.

[53] The Law Commission records that "unlike the defence of laches, acquiescence is not dependent on the plaintiff's delay but does require the plaintiff to have given an express or implied representation that he or she will not require performance of the obligation in question or otherwise insist on his or her rights. This may be inferred from the conduct of the plaintiff." Law Commission *The Limitation of Actions* CP 151 (January 1998) 9.20.

will sometimes justify the admission of a stale claim. Of course the courts should be reluctant to admit a stale claim where it would prejudice the particular defendant or where (which will often amount to the same thing) it would be unconscionable for the particular claimant to bring it, but the presumption is always in favour of the litigation of unadjudicated causes[54] and if public policy can be a bar to late claims it can be a justification for their proceeding.

The following public interests, which are amongst the many which might justify the admission of an otherwise stale claim, are of particular relevance to breach of trust.[55]

First, and of most significance to breach of trust, is the public interest in fiduciary propriety (being the desire that fiduciaries should be held to high standards of accountability in relation to positions held by them and transactions carried out by them). Significantly, the public interest in fiduciary propriety has a prophylactic, even symbolic, aspect, for the law requires in relation to the behaviour of fiduciaries that justice should not only be done, but must be seen to be done.[56]

However, the public interest in fiduciary propriety, which presumes against the righteousness of a transaction and requires a self-dealing to be set aside *ex debito justitiae*,[57] is hard to reconcile with the public interest in quiescence of title. Indeed they are diametrically opposed. The former presumes a fiduciary transaction to be bad, for "the burden of proof that the transaction is a righteous one rests upon the trustee."[58] The latter, as Bowen LJ stated in *Re Postlethwaite*[59], presumes a transaction (even alleged self-dealing by a trustee)[60] to be good, for

[54] Lord Millett has observed that "the citizen's right of access to the court" is "conferred by the common law and guaranteed by Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms" *Johnston v Gore Wood* (n 3 above) 118D-E. Followed in *Specialist Group International Limited v Deakin* [2001] EWCA Civ 777 [10] (Aldous J).

[55] Other relevant public interests include "the setting of a socially valuable precedent": S Shavell "The Level of Litigation: Private versus Social optimality of Suit and of Settlement" (1999) 19(1) 1999 Intl Rev of Law and Economics 99, 113); the national interest in recovering profits made through the exploitation of sensitive public office (on facts such as those in *Reading v AG* [1951] AC 507 (HL) and *A-G v Blake* [2000] 1 AC 268 (HL); and respect for international human rights (for example in cases concerning the restitution of holocaust-era assets).

[56] According to Viscount Dunedin in *Wright v Morgan* [1926] AC 788 (PC) 798, the inquiry according to which one determines whether there is a fiduciary conflict of interest requires the court to ask "not what was done, but what might be done." Although, as Lindsay J recognised in *Re Drexel Burnham Lambert UK Pension* [1995] 1 WLR 32, a great many cases have been decided as exceptions to that general rule, for example, *Holder v Holder* [1968] Ch 353.

[57] See n 17 above.

[58] *Williams v Scott* [1900] AC 499 (HL) 508.

[59] (1889) 60 LT Rep 514 (CA).

[60] In *Re Postlethwaite* (1889) 60 LT Rep 514 (CA) three trustees sold land in Jan 1854 to a purchaser, who sold it on in June of the same year to one of the trustees. That trustee sold the land 20 years later at a great profit, and in 1888 the trust beneficiaries sought to have the original sale set aside as a self-dealing, alleging that the sale to the third party intermediary had been a sham. Bowen LJ noted that the court had been "asked to displace a transaction as impeachable which took place thirty-four years ago, and when all the parties who could give an explanation are dead" and therefore held that "so long as a reasonable explanation is possible we ought not to draw inferences in favour of the invalidity of the transaction" (520). If the trustee had actually admitted the self-dealing it is possible that even 34 years delay would not have been a bar.

after the passage of long time "[t]he general presumption which the law makes is in favour of the good faith and validity of transactions, and not against them."[61]

Clearly there must come a point in time at which the public interest in fiduciary propriety and the public interest in quiescence of title, being diametrically opposed, cancel each other out. In *Re Postlethwaite* that point was reached after 34 years. When that point is reached the only option for the court is to do nothing, with the result that the property will remain with the possessor. Crucially, after such long delay, private interests do not readily enter into the picture.[62] As Lord Redesdale observed in *Chalmondeley v Clinton*[63]: "[i]t is immaterial to the public at large whether the estate belongs to A. or B.; but it is material, that the person in possession, should be quieted in that possession."

However, although it is clear that "mere lapse of time will prevent the setting aside of a purchase by a trustee,"[64] it is equally clear "that a longer time is allowed for avoiding purchases by trustees than for avoiding other transactions."[65] Brunyate cites the examples of *Hall v Noyes*[66] where a *bona fide* sale by an executor to himself was avoided after 10 years, and *Turner v Trelawney*[67] where a sale of mining property by a trustee in bankruptcy to himself was set aside after 15 years. Brunyate suggests that the latter is "a very strong case, for the sale was in good faith, and the value of the property, which originally was small, had been much increased by the efforts of the trustee and his collaborators."[68] It is submitted that the special public character of a trustee in bankrupty might explain why the public interest in quiescence of title was for so long overridden by the public interest in fiduciary propriety in that case. The public interest in quiescence of title will also be more pronounced in cases where stale actions will prejudice third parties, as where members of the trustee's family have innocently changed their position in reliance upon the trustee's apparent ownership of the trust property.[69]

[61] *Re Postlethwaite* (n 60 above) 520. In *Chalmondeley v Clinton* (1821) 4 Bligh 1 Lord Redesdale observed that ". . . almost the whole property in the country . . . is covered in some way or other by equitable interests . . . possession is always regarded by the law as prima facie title, and it is so regarded with a view to public benefit . . . because it is the public policy that possession should remain undisturbed" (74–75); and that "courts of equity have felt at all times the necessity of quieting possession, by prescribing limitations to suits" 94–95.

[62] Brunyate (n 21 above) suggests that "since the rule that a trustee cannot purchase the trust property or the interest of the cestui que trust does not depend upon a presumption of undue influence, such a purchase can be set aside even though the cestui que trust has confirmed it when he had full knowledge of the facts and was not under the trustee's influence . . . The Courts of Equity do, however, require that such transactions shall be avoided if at all within a reasonable time. The only question is what time is reasonable" 243–4.

[63] (1821) 4 Bligh 1,124.

[64] Franks (n 21 above) 257.

[65] Brunyate (n 21 above) 244.

[66] 3 Ves Jun 748.

[67] 12 Sim 49.

[68] Brunyate (n 21 above) 244.

[69] "The effect of acquiescence is increased where the property has passed through various hands, and the purchasers have laid out money upon it, and a title will be validated by time even though founded on breach of trust" Lightwood (n 26 above) 265.

Second in the list of policy reasons in favour of late litigation is the social desirability of family harmony.[70] It is Franks who suggested that laches (in the sense of acquiescence) will not be so readily inferred in the case of suits between relatives "for in such circumstances it is painful to commence proceedings."[71] It might be objected that this pain is an entirely private affair and family harmony likewise.[72] However, for every authority in the law of trusts that appears to place the family firmly in the private domain,[73] authority can be found to suggest that the well-being of families is in the public interest.[74] Whatever the state of the authorities, surely any suggestion that the internal harmony of families is of no concern to society at large is simply unrealistic.[75] Accordingly, where there is scope for judicial flexibility and discretion, as there is in the application of the doctrine of laches, it would be quite legitimate for the judges to makes some allowance for family harmony.

Third, it might be argued (though less convincingly perhaps than the factors of fiduciary propriety and family harmony) that the claimant's impecuniosity ought to be taken into account where it has contributed to or caused delay. In *Rochefoucauld v Boustead*[76] counsel for the claimant (a comtesse) made precisely this submission, when he argued that the claimant had "merely delayed to sue because she was short of funds and was afraid to embark in such a costly litigation."[77] Lindley LJ, disposing of the case on other grounds, declined to consider that submission on its merits.[78] However, in the recent case of *Johnson v Gore Wood* the House of Lords did consider the claimant's lack of funds to be a relevant factor when deciding to allow an action to proceed which could have been raised by the claimant as part of earlier litigation on the same factual matter.[79] In *Johnson* it appears to have been assumed that the claimant's impecuniosity, if it had any relevance, was relevant only as between the parties to the particular suit. It was never suggested that consideration of impecuniosity

[70] See *Hercy v Dinwoody* (n 42 above).

[71] Franks (n 21 above) 239 Note *Re Howlett* [1949] Ch 767, n 13 above. The claimant was the trustee's son and had delayed his suit until after his father's death. Note also *Jones v Higgins* (1866) LR 2 Eq 538 and *Phillipson v Gatty* (1847) 7 Hare 516, 523.

[72] In *Re Brogden* (1888) 38 ChD 546 (CA) a trustee did not escape the consequences of his neglect of duty, even though his neglect was attributed to his being "[f]earful of the disruption of family relations."

[73] For example the long-standing distinction between "private" family trusts and "public" charitable trusts: *Caffoor and Others v Commissioner of Income Tax, Colombo* [1961] AC 584 (PC).

[74] For example, the long-standing presumption that the relief of the poverty of one's own family is for the public benefit and therefore charitable: *Re Compton* [1945] Ch 123.

[75] Many commentators have criticized the notion that the family can be placed exclusively within the private sphere. See J Eekelaar "What is Critical Family Law?" (1989) 105 LQR 244, 254–258, J Dewar *Law and the Family* (Butterworths London 1989) 4–6; A Bainham "Privatisation of the Public Interest in Children" (1990) 53 MLR 206 states (at 207) "since the family is in [a] sense performing a public service, it is inaccurate to view it as operating entirely outside the public sphere."

[76] [1897] 1 Ch 196 (CA)

[77] *Rochefoucauld v Boustead* (n 76 above) 202.

[78] *Rochefoucauld v Boustead* (n 76 above) 212.

[79] As was the case in *Johnson v Gore Wood* [2001] 2 WLR 72 (HL) 90 G–H.

might be in the public interest. However, it is submitted that the prejudice caused to a defendant by a tardy claim is the same whether caused by the claimant's impecuniosity, forgetfulness or some other characteristic of the claimant of which the defendant will typically be unaware. It is submitted, therefore, that the claimant's impecuniosity does not go to the justice between the parties and should in fact be considered primarily because of the public policy which desires that access to justice should not depend upon wealth. In cases of breach of trust the problem of the impecunious claimant may be especially acute, given that the claimant's wealth will very often be locked within the subject matter of the claim.

## 3 Reform

At present the doctrine of laches only applies to breaches of trust which are not subject to a statutory limitation period; of which the most significant are those committed fraudulently, those involving an infringement of the rules on "self-" or "fair-dealing," and cases where the trustee is still holding trust property. However, under the new Limitation Act[80] these three situations will (like any other breach of trust) be subject to the standard statutory limitation periods. The statutory limitation periods conclude three years from the date the defendant knew of the claim or ten years from the date when the cause of action first arose; whichever is the shorter.[81] It follows from this that the new Limitation Act will reduce significantly the circumstances in which the doctrine of laches, as currently understood, will apply to breaches of trust. This is hard to reconcile with sub-clause 34(2) of the draft Bill, which provides that "[n]othing in this Act affects any equitable jurisdiction to refuse relief on the ground of delay, acquiescence or otherwise."[82] That sub-clause ought to state that "nothing in this Act *removes* any equitable jurisdiction to refuse relief on the ground of delay . . . etc." There can be no doubt that the new Act will *affect* the current equitable jurisdiction to refuse relief on the ground of delay in at least two important respects.

First, the doctrine of laches will in future apply to breaches of trust that are subject to a statutory limitation period, because every breach of trust will be subject to a statutory limitation period under the proposed new regime. Second, the current doctrine of laches will be replaced by a subtly different doctrine for the preclusion of claims on the ground of delay. Both changes are suggested by the following (somewhat obscurely worded) passage from the law commission report:

> . . . the claimant may bring a claim within the limitation period, but after delay which would lead to the claim being barred under the current law for *laches*. Under our

[80] Proposed by the Law Commission in Report No. 270 (n 10 above)
[81] Clause 1.
[82] Clause 34(2).

recommendations the court with (*sic*) retain the power to deny the claim on the grounds of delay even though the relevant limitation period has not expired.[83]

The need to depart from the current orthodox understanding of laches, which conceptualizes laches as a method for preventing the *unconscionable* assertion of a right, is confirmed by the fact that the statutory 10-year period will only apply where the claimant lacked knowledge of his right for most (if not all) of the period of his delay. It is hard to see how a claimant could be guilty of unconscionable delay when throughout the period of the delay he had been unaware of his right to make a claim. Of course, if the claimant is aware on the date when he eventually brings his claim that the particular defendant will be especially prejudiced as a result of the delay, it might be unfair to allow the claim to proceed. However, even then it would stretch the language too far to dismiss his claim as unconscionable unless the claimant was in some way responsible for the special prejudice.

Earlier in this Chapter it was suggested that unconscionability is an inappropriate basis for the doctrine of laches. It was suggested that it should be replaced by more general considerations of *inter partes* fairness. In this respect the Act represents a step in the right direction. It could, however have gone further. First, by abandoning the orthodox, but unnecessary, connection between equity and the discretionary preclusion of civil causes on the ground of delay. There is no reason in principle why the common law should not have a rule barring late suits not otherwise barred by statute.[84] Second, by preserving judicial freedom to take into account public policy justifications for the late bringing of claims.[85] The Act subjects all breaches of trust—even those involving fraud, infringement of the "self-dealing" or "fair-dealing" rules and retention of trust property—to inflexible limitation periods.[86] In private trusts the standard statutory periods for breach of trust will only be relaxed where the claimant is a child,[87] is under a disability[88]or has an interest that has not vested in possession.[89]

This lack of flexibility is regrettable. The Law Commission acknowledged Lord Millett's view that "[t]here is a case for treating fraudulent breach of trust differently from other frauds . . . if what is involved really is a breach of trust,"[90]

[83] Para 4.277.
[84] In *Companhia de Seguros Imperio v Heath* [2001] 1 WLR 112 (CA)124 E-F, Sir Christopher Stoughton opined that differences based on the equitable nature of the doctrine of laches had perhaps been overstated.
[85] These include the need to facilitate restitution of the proceeds of fraud, conflict of interest and "war crimes," the advancement of family harmony; the setting of a socially valuable precedent, and access to justice for the impecunious.
[86] As the Law Commission report puts it: the "core regime" is one in which "[t]he courts would *not* have a discretion to disapply a limitation period" (n 10 above) 11.16 (4).
[87] Clause 28.
[88] Clause 29.
[89] Sub-clause 22(1).
[90] Para 2.42 of the report, referring to *Paragon* (n 22 above) 414 (Millett LJ).

but the draft Bill contains no provision to give effect to the acknowledged special status of fraudulent breaches of trust. It is also significant that, while 85 per cent of respondents to the Law Commission's original consultation document on the subject agreed that breach of trust should be subject to the standard limitation periods, nearly 20 per cent of respondents felt that fraudulent breach of trust should be treated differently. Furthermore, around 30 per cent of respondents were of the opinion that "fair-dealing" and "self-dealing" should be treated outside the core regime.[91] These significant minority views find no expression in the draft Bill.

Other doctrines of civil procedure reflect public interests every bit as necessary to the preservation of the judicial economy as the limitation of actions. We will see that *res judicata*, election and the so-called rule in *Henderson v Henderson* all promote the public interest against the duration and proliferation of litigation. None of them, however, is as inflexible and unyielding as the "core regime" proposed by the Law Commission. The mouths of the contesting parties must, of course, be taped up after a period of time, even if truth is thereby shut out. It is, however, quite another matter to tape up the mouths of judges when it might be appropriate for them to voice public concerns:

> For a policy of closure to be compatible with justice, it must be attended with safeguards: so the law allows appeals: so the law, exceptionally, allows appeals out of time: so the law still more exceptionally allows judgments to be attacked on the ground of fraud: so limitation periods may, exceptionally, be extended.[92]

Nevertheless, even if there is no potential under the terms of the Act for admitting causes beyond the 10 year period, it might be possible to admit causes, even after 10 years' delay, in order to prevent the statute itself from being used as an instrument of fraud. Suppose the defendant deliberately misled the claimant into thinking that the limitation period was longer than 10 years. He might have promised "to settle the matter before the end of the 12 year limitation period." Surely in such a case the defendant would be unable to rely on the true statutory limitation period in order to facilitate his fraud. The same argument has, of course, been used to disapply statutory strictures relating to documentary formality.[93]

Finally, even if no creative means can be found for admitting causes beyond the 10-year period under the new scheme, there will at least be some scope for taking advantage of the flexibility of the doctrine of laches within the 10-year period. Obviously mere delay of less than 10 years will be insufficient to establish laches, but delay combined with *inter partes* factors, such as the likelihood of special hardship to the particular defendant, might justify the barring of the

[91] Para 4.96.
[92] *The Ampthill Peerage* [1977] AC 547 (HL Committee for Privileges) 575G-H (Lord Wilberforce).
[93] *Rochefoucauld v Boustead* [1897] 1 Ch 196 (CA). Limitation statutes are quite closely analogous to formality statutes inasmuch as both reflect a desire to promote certainty and avoid litigation. Both will therefore shut out the justice of an individual claim in the general interest.

claim even before the full 10 years have run. What period of delay less than 10 years will be required before courts entertain the possibility of laches remains to be seen, but there is no precedent for a finding of laches without at least a minimum of six years delay. However, before courts bar claims within the 10 years on the basis of "general" *inter partes* considerations (whether expressed in terms of unconscionability or prejudice or fairness—preferably the latter) it is hoped that they will acknowledge the significance of public interest considerations to the discretionary preclusion of tardy civil claims. It is submitted that where the claim serves some public interest, perhaps in one of the ways set out in this Chapter, courts should allow the full 10 years to run unless some "specific" doctrine of inter partes justice (such as an orthodox estoppel) ought to bar the claim.

## B CAUSE OF ACTION ESTOPPEL

The doctrine of *res judicata* prevents the re-litigation of a cause of action that has proceeded to final adjudication. Once the cause has merged in a final judgment an estoppel *per rem judicatam*[94] is raised to prevent re-litigation of the matter. The doctrine of *res judicata* gives effect to a number of public interests, including the need for finality of litigation, the desire that defendants should not be vexed by a multiplicity of suits and the need to prevent conflicting judgments on the same facts becoming a matter of public record.[95] Where, on the other hand, a cause has not yet been the subject of adjudication, the basic presumption of English law is that the cause may still be litigated. In the previous section we observed that this presumption might be rebutted by the claimant's delay if that delay is such as to bring the Limitation Act 1980 or the doctrine of laches into effect. In this section we will note that the presumption is also rebutted where the cause of action, though not previously adjudicated upon, could and should have been raised as part of an earlier action which has already been finally concluded. This long-standing principle of civil procedure was for many years considered to be a wider form of the "cause of action estoppel" branch of *res judicata*, but has lately been regarded as an instance of the doctrine of abuse of process.[96]

[94] A description which covers both cause of action estoppel and issue estoppel. For the distinction between the two, *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591 (HL) 619–620 (Viscount Dilhorne).

[95] *House of Spring Gardens Ltd v Waite* [1991] 1 QB 241 (CA) 255B-C (Stuart-Smith LJ) illustrates that the desire to avoid inconsistent judgments also has an international dimension. Indeed, the desire to avoid inconsistent judgments was the main purpose behind the *Convention on Jurisdiction and the Enforcement of Judgments in Civil and Commercial Matters*, Art 5(3). 27 September 1968; see *Handelskwekerij G J Bier BV and Another v Mines de Potasse D'Alsace SA* [1978] QB 708 (ECJ).

[96] See *Bradford & Bingley Building Society v Seddon* [1999] 1 WLR 1482 (CA) 1490 (Auld LJ); *Johnson v Gore Wood* [2001] 2 WLR 72 (HL).

Throughout its many incarnations, and rightly or wrongly, the principle has carried the name of an early case in which a version of it was laid down. It is known therefore as "the rule in *Henderson v Henderson*."[97] This so-called "rule", or doctrine, shares with laches the public interest in an eventual end to litigation. Laches reflects this public interest through its concern to preclude the initiation of an action after long delay; the "rule" in *Henderson v Henderson* reflects the public interest through its concern to preclude a claim where it is delayed until after the conclusion of an earlier action on the same matter.[98]

The leading case on the "rule" in *Henderson v Henderson* is the recent decision of the House of Lords in *Johnson v Gore Wood*.[99] This was a case in which Mr Johnson, the managing director and controlling shareholder of a company, brought a personal action against his solicitors for professional negligence, despite having already settled a similar claim brought by his company against the same firm of solicitors; both claims having arisen from substantially the same set of facts.

In *Johnson*, Lord Bingham held that the proper application of the rule in *Henderson v Henderson* should be "a broad, merits-based judgment which takes account of the public and private interests involved and also takes account of all the facts of the case, focusing attention on the crucial question whether, in all the circumstances, a party is misusing or abusing the process of the court."[100] He had earlier observed:

> *Henderson* v. *Henderson* abuse of process, as now understood, although separate and distinct from cause of action estoppel and issue estoppel, has much in common with them. The underlying public interest is the same: that there should be finality in litigation and that a party should not be twice vexed in the same matter. This public interest is reinforced by the current emphasis on efficiency and economy in the conduct of litigation, in the interests of the parties and the public as a whole.[101]

The challenge is to identify the proper relationship between, and relative weight to be attached to, the distinct public and private interests relevant to determining whether successive actions should be permitted to be brought on the same subject of litigation. Lord Millett's response to this challenge was, it is submitted, the correct one:

[97] (1843) 3 Hare 100. See G Watt "The Danger and Deceit of the Rule in *Henderson v Henderson*: A New Approach to Successive Civil Actions Arising from the Same Factual Matter"(2000) 19 CJQ 287–314; and G Watt "*Henderson* is Dead! Long Live *Henderson*! The Modern Rule of Abuse of Process" (2001) 20 CJQ 90–101.

[98] *Barrow v Bankside Agency Ltd*. [1996] 1 WLR 257 (CA).

[99] [2001] 2 WLR 72 (HL).

[100] The public interest underlying *Henderson* was "that there should be finality in litigation and that a party should not be twice vexed in the same matter . . . is reinforced by the current emphasis on efficiency and economy in the conduct of litigation" *Johnson v Gore Wood* (n 99 above) 90D (Lord Bingham).

[101] *Johnson v Gore Wood* (n 99 above) 90A.

> It is one thing to refuse to allow a party to relitigate a question which has already been decided; it is quite another to deny him the opportunity of litigating for the first time a question which has not previously been adjudicated upon. This latter (though not the former) is prima facie a denial of the citizen's right of access to the court conferred by the common law and guaranteed by Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms . . . the doctrine now under consideration can be no more than a procedural rule based on the need to protect the process of the Court from abuse and the defendant from oppression.[102]

One merit of his Lordship's approach is that it confirms the general presumption in favour of the litigation of an unadjudicated cause. An individual's right of access to justice should be presumed to outweigh the public interest in the preservation of the judicial economy unless the contrary is clearly shown (even though, paradoxically, the guarantee of the general right to access to justice depends upon a viable judicial economy). Powerful though the public interests may be which necessitate procedural doctrines such as laches and abuse of process, and though in an extreme case truth might be shut out, an unadjudicated cause of a substantive nature is not easily lost. Another merit of Lord Millett's analysis is that it appears to distinguish the oppression of the particular defendant from abuse of the court's process.[103] Even if Lord Bingham is correct to suggest that in practice "there will rarely be a finding of abuse unless the later proceeding involves what the court regards as unjust harassment of a party" it is desirable that *inter partes* considerations should so far as possible be kept distinct from the public policy considerations which inform the doctrine of abuse of process.

When deciding whether or not to allow successive litigation on the same matter, orthodox doctrines of substantive law such as contract and estoppel should be addressed first, more general considerations of fairness and justice between the parties should be considered next, and only when *inter partes* considerations have been taken into account should the public interest in protecting the judicial process from abuse be resorted to. This sequence mirrors closely the approach to laches which was recommended earlier. Applying this approach to the facts of *Johnson v Gore Wood* it is arguable that the defendant firm should simply have been estopped from pleading abuse of process. An orthodox estoppel could have been raised against the defendant because there had been a statement by the defendant (through its solicitor) that might be said to have induced the claimant to continue in his omission to bring forward his claim. (The solicitor had stated that Mr Johnson's personal claims would "be a separate claim and it would really be a matter for separate negotiation in due course.") Mr Johnson having relied on that statement, it would have been unconscionable for the defendant to have pleaded abuse of process and thereby to have resiled from

[102] *Johnson v Gore Wood* (n 99 above) 118D–E.
[103] Also 118H–119A: "The burden should always rest upon the defendant to establish that it is oppressive or an abuse of process for him to be subjected to the second action."

its representation, where (as would arguably be the case on the facts) to have resiled from the representation would have caused a detriment to Mr Johnson.

This was in fact substantially the same approach as that adopted by the judge at first instance, who had held that the defendant was estopped by convention from pleading abuse. Lord Bingham, delivering the leading speech in the House of Lords, agreed with that analysis, and Lord Goff also agreed that the defendant was estopped from pleading abuse, but on the basis of an estoppel by representation.

In the light of this, their Lordships' subsequent discussion of the doctrine of abuse of process might, strictly speaking, have been obiter dicta. However, it is often when statements are made "by the way" that inaccuracy threatens to creep in;[104] as appears from the speech of Lord Cooke of Thorndon, who opined:

> The belated raising by the defendants of the contention, more ingenious than realistic, that the settlement had the effect of preventing the personal claim seems to me closer to abuse of process than the plaintiff's conduct in pursuing the claim.[105]

It is submitted that his Lordship should have resisted the temptation to describe the defendant's contention as abusive, when it would have been sufficient to hold that the defendant was, on normal principles, estopped from making the contention in the first place. This is not to deny that the court has an inherent jurisdiction to strike out pleadings on either side as an abuse of process, clearly it does (even though the power is normally exercised against claimants).[106] It is merely to suggest that the employment of the doctrine of abuse of process to address what are essentially *inter partes* issues is potentially detrimental in at least two respects. First, it tends to align the public interest against successive litigation with the private interests of just one of the parties, for the defendant will almost invariably oppose successive litigation. Second, it creates too large and too policy-driven a judicial discretion. The underlying mischief at which abuse of process is directed is the misuse of valuable judicial resources in a manner that is likely either directly or indirectly to bring the judicial process into disrepute, whereas in a case like *Johnson* "the Court is not so much protecting its own process as the interests of the defendant."[107]

The danger that abuse of process will subsume what should be quite distinct *inter partes* considerations is latent even in Lord Bingham's analysis, for Lord Bingham regards the question whether there is or is not an abuse on any given set of facts to be a question of common sense. The trouble is, of course, that

[104] Witness Lord Millett's (expressly obiter comments)*Johnson v Gore Wood* (n 99 above) 120B-C where the link between unconscionability and abuse of process is unhelpful.

[105] *Johnson v Gore Wood* (n 99 above) 101 E–F.

[106] There is a power to strike out any "statement of case" which appears to the court to be "an abuse of the court's process or is otherwise likely to obstruct the just disposal of proceedings." Civil Procedure Rules 1998 rr 3.3 and 3.4(2)(b).

[107] *Johnson v Gore Wood* (n 99 above) 120 F-G (Lord Millett). The undesirable confusion of public and private interests in the doctrine of abuse of process can be traced back to Lord Diplock in *Hunter v Chief Constable of the West Midlands Police* [1982] AC 529 (HL) 536.

one can never guarantee that any two courts will share a common sense of what constitutes common sense. *Johnson v Gore Wood* illustrates this well, for the Court of Appeal held that the claimant's personal action was an abuse whereas the House of Lords held that it was not. Admittedly, the Court of Appeal may not have found an abuse if it had taken into account the claimant's impecuniosity and the presumption in favour of the litigation of unadjudicated causes, but the fact remains that an appeal to common sense in no way cuts down upon the width of the courts' discretion to find an abuse of process. That of course is what the House of Lords intended should be the outcome in *Johnson*, and as an outcome it is valid enough, so long as the public policy-driven doctrine of abuse of process is not permitted to occupy territory more appropriately occupied by the parties themselves.

## C ELECTION

"A man is said to be put to his election when he is called upon to choose between two mutually exclusive courses under such circumstances that his choice of either will be irrevocable."[108] Two types of election are of special relevance to cases of breach of trust. The first is the choice whether or not to pursue a remedy at all. Thus beneficiaries must decide whether to avoid a voidable transaction (such as self-dealing by their trustee),[109] whether to claim unauthorized profits made by their trustee from his position of trust[110] and whether to complain when their trustee has used trust funds to make an unauthorized purchase of an asset.[111]

The second type of election is the choice between alternative inconsistent remedies, the classic instance being the choice between the remedy of account and the remedy of compensation in cases where the trustee has misappropriated trust property to his own use.[112] Another instance of election between alternative inconsistent remedies is the beneficiary's option to decline a proportionate proprietary share of assets purchased *in part* with misapplied trust monies, in favour of taking instead a lien over the assets as security for a personal claim against the trustee.[113] A related instance is the beneficiary's option to claim

[108] J Brunyate (n 21 above) 217.

[109] The beneficiary might elect instead to adopt, confirm or ratify the transaction, or might by his conduct or acquiescence be said to have elected to waive his remedy.

[110] For example, on facts like those in *Keech v Sandford* (1726) Sel Cas Ch 61, where a trustee renews in his own name a lease which is the property of the trust, "the *cestui que trust* must elect whether to give up his right in the renewed lease or to sue for a declaration that the lease is held upon a constructive trust for him" Brunyate (n 21 above) 218.

[111] "The fact that he does not . . . complain of the acquisition of the asset but seeks to take advantage of it does not mean that he adopts or ratifies it—he will almost certainly plead that it was a breach of trust—it means only that he does not seek a remedy in respect of it" *Boscawen and Others v Bajwa and Another* [1996] 1 WLR 328 (CA) 342B (Millett LJ).

[112] See *Tang Man Sit v Capacious Investments Ltd* [1996] 1 AC 514 (PC).

[113] This species of election, in some doubt since *Re Hallett's Estate* 13 ChD 696 (CA) 708 (Sir George Jessel MR), was affirmed in the House of Lords in *Foskett v McKeown* [2000] 2 WLR 1299, 1327G.

against the trustee who has paid away trust money or to claim against the person to whom the trust money has been paid.[114] A further example of election between alternative inconsistent remedies, which applies where a trustee has wrongfully employed the trust fund in his own trade, is the claimant's option to take compound interest in lieu of that portion of the trustee's trading profits which is derived from the wrongful use of the trust fund.[115]

The first type of election, between pursuing a remedy or foregoing a remedy, must be made within a reasonable time. It is a close relation to laches.[116] If we take the example of the claimant's decision whether or not to avoid a self-dealing by the trustee, say the purchase by the trustee of shares held by the trust, it is clear that the claimant who delays his election is able, in effect, to gamble on a certainty at the defendant's expense. If the shares do well, the claimant will seek to have the self-dealing set aside; if the shares do badly the claimant will allow the self-dealing to stand. Clearly the claimant cannot be permitted to delay his election until such time as the shares start to look attractive.

The second type of election, election between alternative inconsistent remedies, is quite different. It applies when litigation has already commenced. In such a case the claimant has taken the risk that he will lose the proceedings and be ordered to pay the costs. He cannot be said to be gambling solely at the defendant's expense and it follows that there is no requirement that an election of this type be made within a reasonable time; the only requirement is that it be made before judgment is entered. The remainder of this section will be devoted to election of this type; the leading case in the context of breach of trust[117] being the decision of the Privy Council in *Tang Man Sit (decd) (personal representative) v Capacious Investments Ltd*.[118]

According to Lord Nicholls in *Tang Man Sit*, a claimant faced with cumulative remedies is not required to make an election at all. "He may have both remedies. He may pursue one remedy or the other remedy or both remedies, just as he wishes. It is a matter for him. He may obtain judgment for both remedies and enforce both judgments."[119] Lord Nicholls acknowledges that there are, however, certain limitations to this general right. One limitation is "the so-

[114] "By suing one he does not in any sense waive the claim against the other. He must of course elect between the alternative remedies but there is no final election until a judgment is obtained and satisfied" *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 (HL) 30 (Lord Atkin).

[115] *Vyse v Foster* 1872–73 8 LR Ch App 309 (HL) 334.

[116] "Where lapse of time is an element in the more general defence that the plaintiff has released or waived his rights or has elected not to assert them or is estopped from asserting them, then lapse of time is said to operate by way of acquiescence. On the other hand, lapse of time may operate as a defence in itself; it may for example have made it impossible for the defendant to prove his case because his witnesses have died; in such a case the plaintiff may be *barred* by his laches, using the word in the narrow sense, although there will be no acquiescence" Brunyate (n 21 above) 189. See, also, *Allcard v Skinner* (1887) 36 ChD (CA) 145 and *Edwards v Carter* [1893] AC 360 (HL).

[117] The trust was a bare trust arising out of a commercial joint venture not dissimilar to the trust in *Banner Homes Group Plc v Luff Developments Ltd (No.1)* [2000] Ch 372 (CA).

[118] [1996] 1 AC 514 (PC) noted by P Birks (1996) 112 LQR 375.

[119] Same case 522D.

called rule in *Henderson v Henderson*,"[120] which was considered earlier. Another is the court's power "to ensure that, when fairness so requires, claims against more than one person shall all be tried and decided together."[121] A third is the rule against "double satisfaction," which provides "that a plaintiff cannot recover in the aggregate from one or more defendants an amount in excess of his loss."[122]

This is all well and good for the claimant blessed with cumulative remedies, but the claimant presented with alternative inconsistent remedies is in a quite different position. He is required to make an election between them. Part of the reason for this is simple equity between the parties,[123] for an election will prevent the "double satisfaction" of the claimant. However the rule against double satisfaction, which provides "that a party who is entitled to damages cannot recover twice over for the same loss," is a different rule to that which requires an election between alternative inconsistent remedies.[124]

For one thing, the rule against "double satisfaction" operates at the moment of judgment or after, whereas the doctrine of election between inconsistent remedies operates at the moment of judgment or before. For another, whereas the rule against double satisfaction is almost exclusively concerned with *inter partes* considerations (ie, the desire that particular claimants should not be permitted to recover more than that which is due to them from particular defendants), the doctrine of election, like the doctrine of laches and the rule in *Henderson v Henderson*, promotes wider public interests alongside its concern for justice between the parties. As Lord Nicholls stated in *Tang Man Sit*:

> Like all procedural principles, the established principles regarding election between alternative remedies are not fixed and unyielding rules. These principles are the means to an end, not the end in themselves. They are no more than practical applications of a general and overriding principle governing the conduct of legal proceedings, namely that proceedings should be conducted in a manner which strikes a fair and reasonable balance between the interests of the parties, having proper regard also to the wider public interest in the conduct of court proceedings.[125]

It might be objected that the doctrine of election is solely concerned to prevent double satisfaction *inter partes*, and that the public interest in the judicial process has nothing to do with the matter. There is some force in this objection. Indeed, there is even authority to suggest that a final judgment is, as a matter of

120 Same case 522F.
121 Same case.
122 Same case.
123 In *Johnson v Agnew* [1980] AC 367 (HL) Lord Wilberforce said "Election, though the subject of much learning and refinement, is in the end a doctrine based on simple considerations of common sense and equity" (398). In *Tang Man Sit* Lord Nicholls approved this dictum [1996] 1 AC 514 (PC) 522B–C.
124 *Foskett v McKeown* [2000] 2 WLR 1299 (HL) 1313F (Lord Hope of Craighead).
125 *Tang Man Sit* (n 118 above) 521H–522B.

law, equivalent to satisfaction, [126] from which it would follow that election prior to judgment prevents an immediate double satisfaction. The better view, however, is that the rule against double satisfaction is concerned with satisfaction as a matter of fact, rather than theoretical satisfaction as a matter of law.

That being the case, if the doctrine of election were merely concerned to prevent a double satisfaction there would be no need to make the election until such time as the claimant had in fact received funds sufficient to satisfy one or other of the alternative remedies. Yet this is not what the law requires. To understand why the election must, as a rule, be made no later than final judgment, one has to look to the public interests which influence the doctrine. These turn out to be substantially the same public interests as those which underpin the doctrine of *res judicata*, namely the need for certainty and finality, and the need to prevent two or more inconsistent judgments (arising from the same matter) from appearing on the public record.[127] It is this latter concern, part of a larger concern to prevent judicial process from being brought into disrepute, which goes furthest to explain why election between alternative inconsistent remedies must be made before final judgment is entered in the matter. In seeking to prevent inconsistent remedial awards from appearing within the same judgment, the doctrine of election averts a mischief similar to that of two conflicting judgments on the same matter. Indeed, the reason why the doctrine of election has no application when remedies are cumulative is precisely because a judgment for cumulative remedies does not suffer from logical internal inconsistency in the way that a judgment awarding both of two alternatives clearly does. Whether the remedies are cumulative or alternative, the rule against double satisfaction will apply, but something more applies where the remedies are alternative. That extra factor is, as Lord Nicholls put it: "the wider public interest in the conduct of court proceedings."[128]

Suppose, however, that an internally inconsistent judgment had been entered in error; as would be the case if a judge at first instance ordered a defendant trustee to account for £10,000 he had gained from the trust fund *and* to compensate the trust fund for the loss of the same £10,000. Would the claimant still have to make an election? The answer is yes. However, the damage to the reputation of the judicial process having already been done, the main, perhaps the only, reason for the election in such a case would be to prevent a double satisfaction. This, in essence, is what occurred in *Tang Man Sit*. The facts, it might be recalled, were that Tang, the owner of land, was party to a joint venture for

[126] "Having his election to sue in trover for the value of the goods at the time of the sale, or for the proceeds of the sale as money had and received, the plaintiff elected the former remedy, and he has obtained a verdict and judgment. He has, therefore, got what the law considers equivalent to payment, namely, a judgment for the full value of the goods. . . . . Having once recovered a judgment, his remedy was altogether gone" *Buckland v Johnson* (1854) 15 CB 145, 166 (Maule J).

[127] See n 95 above., cf *Port of Melbourne Authority v Anshun Pty Ltd* (1981) 147 CLR 589 (HC Aus) 603–4.

[128] *Tang Man Sit* (n 118 above) 521H–522B.

the building of houses on the land under which he agreed to assign some of the houses to the claimant after completion of the building works. No assignment was made. Instead, Tang let out the houses as homes for the elderly without the claimant's knowledge or approval. The claimant sought, on the one hand, damages for loss of use and occupation and diminution of the value of the property due to wrongful use and occupation, and, on the other hand, an account of unauthorized profits and compensation for breach of trust. The judge entered judgment in the claimant's favour, in respect of both the restitutionary award and compensation, before the claimant had had the opportunity to consider fully its preferred remedy.

*Tang Man Sit* was an exceptional case. We know that generally the law requires that the election be made prior to judgment for the reasons of public policy we have identified. However, are there any circumstances in which countervailing public interests might lead to a different outcome? One aim of this Chapter has been to demonstrate that the special public interests which apply to cases of breach of trust might sometimes be sufficient to off-set the public interest in expediency, certainty, finality and consistency which are promoted by civil procedural doctrines such as laches and the rule in *Henderson v Henderson*. The same, it appears, may even be true in relation to the doctrine of election. Thus in *Vyse v Foster* it was suggested that the special nature of the trust obligation might justify the setting aside of the usual rule as to election between alternative inconsistent remedies, notwithstanding the obvious possibility that this might result in double satisfaction and an internally inconsistent judgment:[129]

> The application . . . of that rule as to election between interest and profits to the case of an actual loan by a trustee in breach of trust to himself and others, would, we think, require very full consideration before the Court comes to a final decision on it.[130]

Where a trustee has committed a deliberate breach of trust, say misappropriation of trust assets, the public interest in fiduciary propriety might exceptionally justify a relaxation of the usual rule that an election must be made before judgment.

Finally, for all its undoubted importance, one cannot overlook the inherently flexible (one might say unpredictable) nature of the process of weighing public policy considerations one against another. Therefore, in the context of alternative inconsistent remedies the courts should, as in the other procedural contexts we have examined, attend to substantive *inter partes* factors before relying upon any policy basis for disposing of the case. Only rarely will public interests justify an outcome that would be unfair as between the parties, for the public's first interest, at least as far as judicial process is concerned, is in the just disposal of cases. For this reason Lord Nicholls held that he would not have allowed the

[129] (1872) LR 8 Ch App 309 (HL).

[130] *Vyse v Foster* (n 129 above) 334.

claimant to proceed with the damages claim in *Tang Man Sit* if it would have been inequitable as between the parties.[131]

## D CONCLUSION

When Franks suggested that statutory limitation provisions "emphasise the public element" whereas "the equity rule [laches] looks primarily to the conduct of the parties,"[132] his choice of the words "emphasise" and "primarily" was not accidental. He recognized that courts have from earliest times admitted considerations of public policy when applying the doctrine of laches.[133] In contrast, Prime and Scanlan, whose book in other respects adheres closely to Franks' own treatment of the subject, assert that "[u]nlike limitation, the basis of the doctrine of laches lies not in public policy, but on the conduct of the parties and the balance of justice between the parties in granting or refusing the remedy sought."[134] This study has sought to demonstrate that the latter represents an inaccurate reading of past cases and an undesirable approach to future cases. It is, however, an approach which modern courts, by focusing exclusively upon the *inter partes* aspect of laches, and unconscionability in particular, have done little to discourage.[135]

The irony is that despite close functional and doctrinal similarities between the doctrine of laches and the "rule" in *Henderson v Henderson*, in relation to the former modern courts have tended to focus upon *inter partes* considerations to the near exclusion of relevant public policy considerations, whereas in relation to the latter the exact opposite is threatened. The reason for this asymmetry is that the courts have tended to categorize laches as an equitable doctrine rather than as a procedural doctrine (largely due to confusion between laches and acquiescence).[136] Having been thus confined to the equitable sphere, equitable language and equitable paradigms have held sway in the formulation and application of the doctrine. The outcome is an inappropriate emphasis upon unconscionability and insufficient emphasis upon important issues of policy which ought to be weighed in the balance when deciding whether or not to bar a stale action. We have seen that in the context of actions for breach of trust,

[131] It is notable that in reaching the conclusion that "[t]here was no . . . inequity" in allowing the claimant to proceed with the damages claim, Lord Nicholls preferred the term "inequity" to "unconscionability." His lordship has elsewhere lamented the fact that the rather nebulous word "unconscionable" holds such an appeal for equity lawyers *Royal Brunei Airlines v Tan* [1995] 3 WLR 64 (PC) 76.

[132] Franks (n 21 above) 233.

[133] Text from n 40.

[134] T Prime & G P Scanlan *The Modern Law of Limitations* (Butterworths London 1993) Chapter 13.

[135] See *Frawley v Neill* (n 47 above).

[136] In *Cholmondeley v Clinton* (1821) 4 Bligh 1, 78–79 Lord Redesdale, Lord Chancellor of Ireland, and the learned author of a *Treatise on Pleadings in Suits in the Court of Chancery by English Bill* (1780) referred to laches as a principle of law which is found reflected in common law and legislative rules.

fiduciary propriety is one such significant public interest which might in an appropriate case justify the litigation of an otherwise stale claim. The rule in *Henderson v Henderson*, which also originated in the old Court of Chancery, could so easily have suffered the same fate as laches had it not been recognized from the outset to be a doctrine of procedure rather than of equity. However, the price it will pay for that escape may yet be a heavy one. Having been confined to the procedural sphere, procedural language and procedural paradigms have held sway in its formulation and application. The danger is that the outcome will be an inappropriate emphasis upon abuse of process and insufficient emphasis upon relevant *inter partes* considerations.

The aim of this study has been to demonstrate that the three procedural doctrines under consideration are "the means to an end, not the end in themselves."[137] Indeed, the end to which all procedural doctrines strive is the same end to which the new civil procedural rules are directed. It is, "to deal with cases justly . . . expeditiously and fairly."[138] If that end is to be attained the courts must resist all other paradigms and should recognize that the balance of justice in the application of procedural doctrines will only be found when appropriate weight is attached to both private and public interests.

[137] *Tang Man Sit (decd) (personal representatives) v Capacious Investments Ltd* [1996] 1 AC 514 (PC) 522B (Lord Nicholls)

[138] Civil Procedure Rules 1998 SI No 3132 r 1.1(1), (2).

# 13

# *Overview*

DAVID HAYTON

IN THIS REPORT the Chapters are assembled under four heads, "The Nature of Trusts", "Accountability: Damages or Equitable Compensation?", "Tracing, Overreaching, Receipt and Assistance" and "Defences to Breach of Trust Claims." There is a treasure-trove of knowledge and insights packed into the individual chapters. Although what follows is mainly comment, in places the Reporter has added to that store.

## A THE NATURE OF TRUSTS

The chapters relevant to this theme are: Chapter 2 (Getzler) "The Duty of Care," Chapter 10 (Payne) "Consent," Chapter 8 (Penner) "Exemption Clauses" and Chapter 3 (Simpson) "Conflict of Interest." They provoked the question whether the trust obligation was really a contractual "deal" as suggested by Professor Langbein[1]. After all, duties of care may be ousted or modified, conflicts of interest may be authorized, exemptions may be provided for breaches of duties, while consents given to breaches of trust may prevent any legal action being brought over such breaches. In 99 per cent of cases, indeed, there is an agreement between the settlor and the trustee(s) dealing with modifications of the default duties of trustee(s), the terms of an exemption clause and the remuneration of the trustee(s).

However, the consensus was against Professor Langbein's view, not just on historical grounds[2], nor because the settlor drops out of the picture[3] after creation of the trust, nor because of the role played by the Chancery judge and the inherent jurisdiction of the Court[4]. The English trust obligation has at its core

[1] J Langbein "The Contractarian Basis of the Law of Trusts" (1995) 105 Yale L J 625. In England third parties can now enforce contacts for their benefit under Contracts (Rights of Third Parties) Act 1999.

[2] See M Lupoi *Trusts: A Comparative Study* (CUP Cambridge 2000) 166.

[3] *Re Astor's S T* [1952] Ch 534, 542; *Bradshaw v University College of Wales* [1988] 1 WLR 190, 194.

[4] *Re Beddoe* [1893] 1 Ch 547; *Re New* [1901] 2 Ch 534.

assets (whether interests in property or choses in action) owned by a trustee and immune from the claims of the trustee's creditors, heirs or spouse because such assets are regarded in equity as owned by the beneficiaries. The settlor can unilaterally create this situation, whether by declaring himself or herself trustee of the whole or a specific fraction of particular ascertained assets that he or she owns, or by transferring specific assets to a trustee. In the latter case the trustee normally agrees to accept the assets on the terms of the trust but, without the trustee's agreement, the settlor can secretly create a testamentary trust or transfer land or shares in companies where registration in the transferee's name automatically transfers ownership to the transferee.[5]

It is correct that the trustee can disclaim the trust property upon discovery of the trust, but this does not affect the proprietary interest acquired by the beneficiaries on the settlor's death (in the case of testamentary trusts) or as soon as the settlor had done everything necessary to be done by the settlor[6] for putting in train registration of the intended trustee as proprietor of land or of shares where registration is needed for transer of the legal title. Equity does not allow a trust to fail for want of a trustee,[7] so the person who becomes personal representative of the deceased settlor will become trustee (with the statutory power[8] to retire and appoint new trustees) or, if the settlor is alive, then he will become trustee (with the same statutory power).

Moreover, because the effect of the settlor's conduct is the creation of equitable proprietary interests in the trust fund, the beneficiaries can unanimously direct the trustee to transfer to them (or their nominees) the specific assets comprised in the trust fund once all the beneficiaries are ascertained and of full capacity, so that between them they are regarded in equity as owners of all the assets.[9] It is immaterial that this frustrates or contradicts the purposes that the settlor and the trustee may have agreed upon to endure for a longer period.

In most States in the USA, however, the obligation imposed by the settlor on the trustee to carry out a material purpose considered by the settlor to benefit the beneficiaries prevails over the beneficiaries' interests because the courts will not allow them in their own subjective interest to obtain the trust assets from the trustee so long as a material purpose of the settlor remains to be carried out.[10] Otherwise, as in England, the beneficiaries have an equitable proprietary interest that they can vindicate by the tracing process leading to the imposition of an equitable lien or charge upon traced assets or an equitable interest in the whole or an appropriate proportion of the traced assets. Oddly enough, as Professor Birks points out in his Chapter, although "Equity acts *in personam*,"

[5] J Hill "The Role of the Donee's Consent in the Law of Gift" (2001) 117 LQR 127.
[6] *Re Rose* [1952] Ch 499.
[7] *Mallot v Wilson* [1903] 2 Ch 494 approved in *Harris v Sharp* (CA 21 March 1989).
[8] Trustee Act 1925 s 36.
[9] *Saunders v Vautier* (1841) 4 Beav 115; *Stephenson v Barclays Bank Trust Co Ltd* [1975] 1 WLR 882.
[10] Eg, to have accumulation of income continue or to ensure that B as trustee of a 51 per cent shareholding for his siblings C, D, and E and as beneficial owner of a 25 per cent shareholding can continue to control and run the family company.

equitable proprietary interests can be vindicated in an action having *in rem* effect (the results of an *inter partes* action being that the defendant is ordered to transfer specific property to the claimant to hold as trustee or, exceptionally, for his or her own benefit). In contrast, while the Common Law is regarded as acting *in rem,* in the case of personalty it does not provide proprietary remedies, not going beyond a strict liability to pay damages.

Thus, the Anglo-American trust obligation creates equitable proprietary interests that bind subsequent owners of the affected property unless they are bona fide purchasers of a legal title for value without notice of the beneficiaries' interests or are protected by overreaching provisions (eg, payment of capital moneys from land to at least two trustees or a trust corporation[11]) designed to facilitate the marketability of property. Not only are trust assets and their traceable product in the ownership of the trustee immune from the claims of the trustee's creditors, heirs and spouse, but trust assets and their traceable products in the hands of a third party are immune from the claims of that third party, or creditors, heirs or the spouse of such party, unless such party is a bona fide purchaser as above or a person protected by overreaching provisions as above (or the successor-in-title thereto). Such immunity arises from the nature of the equitable proprietary interests conferred upon beneficiaries of the trust obligation imposed upon a trustee by the settlor, although a Civil Law jurisdiction can confer such immunity for segregated trust property owned by a trustee by statutory provisions conferring immunity upon the insolvency, death or divorce of the trustee or by case-law developments affecting heirs or spouses who knowingly receive trust property.[12]

The proprietary aspect of the trust obligation has been taken to the limit in England ,[13] although slightly curtailed by most States in the USA which, as seen, have a law preventing absolutely entitled beneficiaries taking advantage of the *Saunders v Vautier* principle to claim the trust assets as their own if a material purpose of the settlor still subsists.[14] There is, however, scope to develop further the obligational characteristic of the English trust.

Except for charitable purpose trusts (with a different history from private trusts and special legislation allowing enforcement not just by the Attorney-General but by the Charity Commissioners or "any person interested" if the Charity Commissioners or the court consider such person should have *locus* standi[15]), just as at the core of a car is the engine, so at the core of the trust is

[11] Law of Property Act 1925 s 27.

[12] D Hayton, S Kortmann & R Verhagen (eds) *Principles of European Trust Laws* (The Hague Kluwer Law International 1999).

[13] Contingent interests can be utilised to escape *Saunders v Vautier*, while as a matter of contract, as in the case of unit trusts, it can be arranged that no interests in underlying property arise until a specified event occurs: K F Sin *The Legal Nature of the Unit Trust* (OUP Oxford 1997) 114–120.

[14] If such absolutely entitled beneficiaries sought to obtain English trust assets, presumably the English courts would characterise the beneficiaries' rights under eg, New York law as choses in action against the trustees who would have a defence where a material purpose of the settlor remained to be achieved.

[15] Charities Act 1999 s 33; *Richmond LBC v Rogers* [1989] Ch 484.

the obligation of the trustee to account to the beneficiaries (literally by providing accounts that the beneficiaries can then falsify or surcharge as discussed later). Thus, the settlor must create a trust that directly or indirectly benefits persons with *locus standi* positively to enforce the obligation in their favour[16]. Otherwise, there is no trust, as happens where there are trusts for non-charitable purposes that are abstract or intangible eg, trusts for the purpose of outlawing vivisection,[17] of furthering the interests of the UK Socialist Party[18] or of a purely contemplative (and, therefore, non-charitable) order of Nuns,[19] or for the purpose of improving sailing standards in English and Welsh sailing clubs.[20]

However, it would seem that if a settlor did not impose a *trust* but conferred a *power*[21] on his trustee to use trust funds for non-charitable purposes (defined with sufficient certainty to enable the default beneficiaries and the court to ascertain whether or not the trustee was about to act—or had acted—beyond the scope of such power) then there is surely no reason for the court to intervene to frustrate the settlor's intention to authorize the trustee to spend his money in such fashion. It is noteworthy, nonetheless, that the court will not save a trust by giving effect to it as a power[22] except as a concession to human sentiment in the case of testamentary trusts to erect and maintain a sepulchral memorial, to maintain pet animals and to have a priest privately perform Catholic masses for the testator's soul.[23]

Offshore jurisdictions, seeing an opportunity to market their trustees' services, have considered that if a settlor wants to create not a power but a non-charitable purpose trust there is no reason to frustrate such intention so long as the settlor in his trust instrument has provided an enforcer, who has *locus standi* to enforce the purpose trust, and a mechanism for succession to the office of enforcer.[24] Bermuda, indeed, after having purpose trust legislation since 1989, has recently gone further by allowing a purpose trust to be enforced by any person considered interested enough by the court and even if no person was originally appointed enforcer.[25] While a trustee can never be an enforcer, the settlor while alive can be enforcer, especially if no persons are to be ascertained as beneficiaries for a considerable period while income is accumulated or paid out to objects of flexible powers of appointment.

[16] *Re Denley's Trust Deed* [1969] 1 Ch 373 but it is difficult to draw the line between purpose trusts validated by this case and purpose trusts that are not, while in *Re Grant* [1980] 1 WLR 360 Vinelott J explained the trusts in *Re Denley* as really discretionary trusts for employees.
[17] *National Anti-vivisection Society v IRC* [1948] AC 31 (HL).
[18] *Re Grant* [1980] 1 WLR 360.
[19] *Leahy v Att-Gen for New South Wales* [1959] AC 457 (AC).
[20] *Re Nottage* [1895] 2 Ch 649 pure sport not being charitable.
[21] *Re Douglas* (1887) 35 Ch D 472, Re Shaw [1957] 1 WLR 729.
[22] *Re Shaw* [1957] 1 WLR 729, 746; cp *IRC v. Broadway Cottages Trust* [1955] Ch 20, 36.
[23] Eg, *Re Hooper* [1923] Ch 38, *Re Dean* (1889) 41 Ch D 552, *Bourne v Keane* [1919] AC 815, 874–875, *Hong Kong Bank Trustee Co v Farrer Tan* [1988] 1 Malayan LJ 485 : such so-called trusts of imperfect obligation, not being positively enforceable by anyone, are really mere powers.
[24] Purpose trust legislation has been enacted in Bermuda, Belize, Cayman, Jersey, and Isle of Man.
[25] Trusts (Special Provisions) Amendment Act 1998 substituting a new Part II of the Trusts (Special Provisions) Act 1989.

Under the Recognition of Trust Act 1987 the English court ought to recognise as valid non-charitable purpose trusts valid under a specified offshore jurisdiction's governing law where an appointed enforcer (whether or not the settlor) is available to ensure that the trustee's obligation to effect the purpose is properly performed, with English public policy[26] being available to strike down illegal or capricious purposes.[27] Indeed, since no enforcer was appointed in any of the English case-law invalidating non-charitable purpose trusts that were in any event void for perpetuity or uncertainty, there seems no reason why the English Court should not uphold a non-charitable purpose trust governed by English law (and restricted to a valid perpetuity period) where an enforcer exists under the terms of the trust instrument to ensure that the trustee carries out the trust obligation. Indeed, so long as there is an unborn or unascertained or infant beneficiary, why should the settlor not be able expressly to reserve to herself or himself the right on behalf of such beneficiaries to make the trustee account for the trusteeship of the trust property?

Surely, there is no good reason why a settlor's intention should not be facilitated, rather than frustrated, where the trust (restricted to a royal lives in being and 21 years perpetuity period) is to further the purposes of the UK Socialist Party to be enforced by the Leader of such Party from time to time or to further the professional interests of practising barristers to be enforced by the Chairman of the Bar of England and Wales from time to time or to further yachting standards of English citizens to be enforced by the President of the Royal Yachting Association. Just as a car needs an engine so a trust needs an enforcer, whether a beneficiary or the Attorney-General or an expressly appointed enforcer: the correlative duty-right obligation vital for the trust concept then subsists, whether the obligation is to benefit beneficiaries or to further charitable purposes or to further non-charitable purposes.[28] Such logical consistency avoids making the virtually unworkable distinction between non-charitable purposes that directly or indirectly benefit persons and those that do not as purposes that are "pure, abstract or intangible," and will make sense to Civil Law countries in Europe as they come to develop for various purposes the use of segregated funds immune from the claims of the owner's creditors, heirs or spouse, so that there is a level-playing field in Europe, especially in the commercial and financial sphere.[29]

[26] See Article 18 of The Hague Convention on the Law Applicable to Trusts and on their Recognition.

[27] In an extreme case, however, the English court may hold there to be a resulting trust eg, where there is a "trust" for "beneficiaries" having no rights whatsoever (except to retain whatever is transferred to them) as under the Cayman Special Trust Alternative Regime Law 1997 if the "enforcer" is someone other than a "beneficiary" who should be recharacterised as only an object of a power, or where the purpose amounts only to an investment clause: DJ Hayton (ed) *Modern International Developments in Trust Law* (The Hague Kluwer Law International 1999) 331–334.

[28] Further DJ Hayton "Developing the Obligation Characteristic of the Trust" (2001) 117 LQR 96.

[29] DJ Hayton, "The Development of the Trust Concept in Civil Law Jurisdictions," (2000) 8 JTCP 159.

## B ACCOUNTABILITY: DAMAGES OR EQUITABLE COMPENSATION

As Professor Chambers points out in Chapter 1, "Liability for Breach", Equity lawyers traditionally pour scorn on those who said that trustees were liable to pay damages to the beneficiaries or to the trustees (who replaced the wrongdoing trustees) for the beneficiaries in order to make good losses or to restore gains arising in breach of trust. A breach of trust is any act or neglect on the part of a trustee which is not authorized or excused by the terms of the trust instrument or by law, or which fails to satisfy the duties imposed on a trustee conducting authorized activities. Many modernists take the view that one may as well call all money payment liabilities "damages," whether arising at common law or in equity, although recognising that the measure of such damages may well be ascertained by different rules in different situations (eg, whether or not the defendant's conduct was negligent or fraudulent, or was a breach of a proscriptive fiduciary duty, or was a breach of a common law duty of care or an equitable duty of care) although, in the interests of rationalisation and simplification, as much assimilation as possible should occur eg, where breaches of duty of care are concerned.

However, Professor Chambers rightly points out that damages or compensation are best restricted to the goal of compensation for losses, while he submits that the terminology of restitution should be used for and restricted to, the goal of requiring the defendant to give up an asset or its monetary value—although one needs to proceed further to distinguish whether such giving up is the result of the claimant's vindicatory proprietary claim or to prevent unjust enrichment of the defendant at the claimant's expense.

The majority of discussants at the symposium considered that there was a danger that a broad-brush damages approach for losses could well lead to poorly-reasoned judgments eroding the protection accorded by Equity to vulnerable beneficiaries (with strict liability for falsification of accounts subject to section 61 of the Trustee Act 1925) and also to third parties dealing with trustees. Lord Templeman, in particular, had warned against the danger of permitting the tort of negligence to become too pervasive.[30]

*Froese v Montreal Trust Company*[31] was a case in point where the beneficiaries of a pension trust were held 2:1 by the Ontario Court of Appeal to be entitled to common law damages for negligence against the defendant custodian trustee which had failed to chase up contributions that should have been paid to it by the employer which had set up the trust with itself as trustee for its employees and which had gone into liquidation. As provided for by the terms of the trust deed, the employer-managing trustee had appointed the custodian trustee to be custodian of moneys paid to it and of investments purchased by it as

[30] *China & South Seas Bank Ltd v Tan* [1990] 1 AC 536 (PC) 543; *Downsview Nominees Ltd v First City Corp* [1993] AC 295 (HL) 315.

[31] (1996) 137 DLR (4th) 725.

directed by the managing trustee (or an investment manager appointed by it) but to be under no duty to chase up contributions due from the employer. The beneficiaries took their interests subject to the burden of the managing trustee exercising its powers in such fashion, and so should not have been able to make the custodian trustee account for any loss resulting from the employer's non-payment of contributions. There was no duty to account for the contributions that the employer failed to pay and thus no order for an account of administration on the basis of wilful default could have been made.

As Professor Chambers emphasises, the right of the beneficiaries to make the trustee account for its stewardship of the trust property is at the core of the trust so that the trustee is under a primary duty (viz independent of any breach of trust) to inform trust beneficiaries of full capacity that they are beneficiaries and thereafter to provide them with accounts of its management and distributive functions[32]: if beneficiaries have no rights to make the trustee account there is no trust for the beneficiaries.[33]

Where the trustee is being difficult over providing accounts and supporting documentation and information, the beneficiaries start by obtaining from the court an order for an account of administration[34] in common form, requiring the trustee to account only for what has actually been received, what has been spent on expenses, fees etc and what has actually been distributed to beneficiaries. The beneficiaries can then see whether there is occasion to falsify or to surcharge the accounts. A falsification is the showing of an entry which is false and needs to be corrected. A surcharge is the showing of an omission where there should be a credited item.

Where the beneficiaries can show misconduct justifying an inference that unknown other breaches have occurred then, after pleading instances of misconduct an order can be obtained for an account of administration on the basis of wilful default, requiring the trustee to account not only for what has actually been received but for what might have been received but for the trustee's wilful default which covers deliberate, reckless and negligent breaches of trust. The burden of proof then lies on the defendant trustee to justify the account.

As Dr Getzler points out, falsification was the first remedy developed against trustees. If T made an unauthorized distribution of £x to C or improperly sold an authorized investment to buy an unauthorized investment for £x or made an unauthorized transfer of trust assets worth £x to an agent or custodian, that transfer of £x or sale or transfer of assets worth £x is deleted, T not being able

[32] DJ Hayton "The Irreducible Care Content of Trusteeship" Ch 3 in AJ Oakley (ed) *Trends in Contemporary Trust Law* (OUP Oxford 1996); *Brittlebank v Goodwin* (1868) LR 5 Eq 541; *Hawkesley v May* [1956] 1 QB 304; *Re Murphy's Settlement* [1998] 3 All ER 1; *Re Rabbaiotti's 1989 Settlement* [2000] WTLR 953; *Rosewood Trust Ltd v Schmidt* (2001) 3 ITELR 734.

[33] *Armitage v Nurse* [1998] Ch 241 (CA) 253.

[34] Generally on orders for an account see *Glazier v Australian Men's Health (No 2)* [2001] NSWSC 6 and Hayton & Marshall *Commentary & Cases on the Law of Trusts and Equitable Remedies* (11th edn Butterworths London 2001) Ch 10 s 2.

to claim that he acted wrongfully beyond his powers. Equity looks on him as having done what he ought to have done, namely to have retained the £x or the assets then worth £x. It matters not that the assets improperly purchased or transferred are now worth a quarter of their value because of a stock-market crash or have been stolen or destroyed by an act of God.[35] Indeed if the assets worth £x that had been wrongfully purchased or transferred will cost £2x to replace then T will have to pay £2x to replace them so that the account truly reflects what the position would have been if T had not acted beyond his powers.[36] This strict liability to pay compensation to restore lost value is designed to encourage T to observe to the full his fundamental duty to do only what is authorized to be done in respect of the trust property.

In the case of gains there is a similar strict liability, but, as Professor Chambers emphasises, it is a "restitutionary" liability to give up an asset or its monetary value, where T acts in breach of the proscriptive fundamental fiduciary duty not to profit from the trusteeship or the use of the trust property nor to put himself or herself in a position where there is a sensible possibility of a conflict between personal interest and duty as trustee. Once there is a prima facie case of breach of the duty of undivided loyalty, then T has a secondary duty to provide an account of activities amounting to such a breach. Rescission is automatically available in respect of dispositions by trustees to one of themselves,[37] while profits are held by T on trust for the beneficiaries even though T acted honestly, improved the value of a trust shareholding, and the trust at the time would not have been able to make the profit for itself.[38] Because the beneficiaries are very vulnerable to the machinations of the trustee, who fully controls everything and alone knows what really happens, there is a strict deterrent liability placed on T to ensure that he only operates within his powers and does not break his "no profit," "no conflict" fiduciary duties unless clearly authorized.[39] Thus, if he mixes £1,000 of trust money with £1,000 of his own in his current bank account this wrongful mixing precludes any identification of the owner of any particular amount, while he is estopped from claiming that the account should be regarded as a half-and-half-owned pool of money because the creation of such pool was a wrongful act. He cannot take advantage of his own wrong nor can he prove that a £1,000 payment (whether paid out before or after another £1,000 payment) was not trust money. Thus, on behalf of the beneficiaries it should be successfully maintained that a payment of £1,000 to

[35] *Clough v Bond* (1838) 3 My & Cr 490, 496–497 endorsed in *Target Holdings Ltd v Redferns* [1996] AC 421, 434.

[36] *Re Massingberd* (1890) 63 LT 296.

[37] *Wright v Morgan* [1926] AC 788 (PC); *Aequitas v AEFC* [2001] NSWSC 14 paras 425–433.

[38] *Boardman v Phipps* [1967] 2 AC 46 (HL); *Attorney General for Hong Kong v Reid* [1994] 1 AC 324 (PC) 338.

[39] Ch 3 (Simpson) and *Nant-y-Glo and Blaina Ironworks Co v Grave* (1878) 12 Ch D 732 (T liable for value of shares improperly received in breach of duty at highest value between date of breach and date of judgment).

purchase Super plc shares (which have doubled in value) was a duly authorized purchase of an investment on behalf of the trust.[40]

Subsequently, where T acted within his powers as trustee and complied with his proscriptive fiduciary duties, but losses arose, Equity allowed T's accounts to be surcharged where there was a failure to take the degree of care or the steps that a prudent trustee would have taken eg, T negligently supervised an authorized agent, or negligently failed to sue the previous trustee for a breach of trust or some third party for breach of contract or a tortious act against the trust property. Surcharging the account requires adding to the account an amount of "equitable compensation" restoring to the trust fund (or any absolutely entitled beneficiary) in the words of Lord Browne-Wilkinson[41] "a loss in fact suffered by the beneficiaries and which, using hindsight and common sense, can be said to have been caused by the breach." Thus, no deduction is made for any tax (eg, inheritance tax on the death of a life tenant or a tenth anniversary of a discretionary trust) that would have been payable but for the breach of trust[42] (unlike the position for common law damages in many cases).

The question arises whether or not equitable negligence claims should be decided by rules more favourable to beneficiaries (taking account of hindsight and of a *causa causans* rather than the *causa sine qua non)* than are the rules for claimants alleging breach at common law of a contractual or tortious duty. While the nature of the fundamental trustee-beneficiary obligation requires strict liability if the trustee acts beyond the powers possessed *qua* trustee or breaches proscriptive fiduciary duties, it is the negligent failure to act as a prudent trustee should have done that is now regarded as the crucial dimension, the trustee-beneficiary relationship being regarded only as an incidental factor.[43] Thus, why should negligent trustees be treated any differently from negligent lawyers, accountants or doctors?[44]

Where a loss is alleged to have been caused by T's failure to diversify investments[45] or to exercise its discretion to sell particular investments[46] or to monitor properly the activities of a 99 per cent owned company,[47] it needs, therefore,

[40] As Lord Millett points out in *Foskett v McKeown* [2001] 1 AC 102 (HL)132 the interests of the wrongdoing trustee responsible for the mixing of moneys are subordinated to the beneficiaries who can locate their contribution as they wish. Equity deems the wrongdoing trustee to have done beneficial acts on behalf of the beneficiaries and he cannot deny this, as emphasised by Lord Millett himself in "Bribes and Secret Commissions" [1993] Restitution LR 20–21, citing Storey's *Equity Jurisprudence* and Professor PD Finn *Fiduciary Obligations* (Law Book Sydney 1977) 221.

[41] *Target Holdings Ltd v Referns* [1996] AC 421(HL) 439; *Maguire v Makaronis* (1997) 188 CLR 449 (HCA) 470; *Aequitas v AEFC* [2001] NSWSC 14 [442]. But hindsight cannot be used to determine whether or not conduct amounted to a breach of trust: *Re Chapman* [1896] 2 Ch 763, 764; *Nestlé v National Westminster Bank* [1993] 1 WLR 1260.

[42] *Bartlett v Barclays Bank Trust Co* [1990] Ch 515 (CA) 543.

[43] *Bank of New Zealand v New Zealand Guardian Trust Co* [1993] 1 NZLR 664, 687.

[44] *Bristol & West BS v Mothew* [1998] Ch 1, 17.

[45] *Nestlé v National Westminster Bank* [1993] 1 WLR 1265, 1281.

[46] *Wight v Olswang* (No 2) [2001] WTLR 291, [2001] Lloyd's Rep PN 269

[47] *Bartlett v Barclays Bank Trust Co* [1980] Ch 515 (CA).

to be proved that but for T failing to do what no reasonable trustee (viz a properly informed trustee exhibiting the requisite standards of care) could possibly have failed to do, the loss would probably not have occurred.

Where T has a discretion and decides to exercise such discretion in a particular way eg, to sell X Ltd shares as soon as practicable, but then fails to implement such decision without any good reason, it can be argued that T has failed to do what no reasonable trustee could possibly have failed to do, so that if such failure caused loss then the accounts should be surcharged with a credit item for the amount of the loss.[48] Alternatively, an analogy can be drawn with the case where the trust instrument required specific original settled assets, like the X Ltd shares, to be sold as soon as practicable. The decision to sell the X Ltd shares as soon as practicable requires such sale to take place and Equity does not allow T to claim that he wrongfully retained such shares. Thus, such retention in the accounts is falsified and automatically replaced with the sum that would have been received if the shares had been sold as soon as practicable.[49] Whatever happened after the date when the shares should have been sold (eg, a dramatic stock-market collapse) is immaterial, whether or not reasonably foreseeable.

Outside of falsifying or surcharging accounts to obtain an order for payment of the sum found due to the trust fund or a restitutionary order for an account of profits arising from misuse of trust property or the office of trustee it is possible, however, for equitable compensation to be available directly to a beneficiary.[50] Take the case of B who tells T that she is £100,000 in debt and therefore desperately looking forward to receiving from T £100,000 to which she becomes entitled under the trust on attaining 30 in two months' time, the 18 per cent interest payments on her £100,000 debt crippling her. Despite this, T does not get round to paying B till three months after her 30th birthday because T was taking a four-month round-the-world trip of a lifetime. While T must account to B for the £100,000 plus three months interest thereon, it seems clear that T would be forced to compensate B in respect of the 18 per cent interest she would not have had to pay if T had promptly paid her the £100,000 (the amount of such compensation being reduced by the amount of trust interest credited to B).

Take the case of T, in accordance with the purpose for which the settlor created a trust with flexible powers, deciding to make an appointment of half the trust capital to O by executing the requisite deed before 2 August when the power expires. He actually does not execute the deed till 2 August so the deed is ineffective and the default beneficiaries are entitled to all, and not half, the capital, so T must account to them for that.[51] Surely O must be entitled to equitable compensation from T. This could be on the basis that T negligently broke T's equitable duty to O. Alternatively, while T actually has to account for the whole

48 *Wight v Olswang* (No2) [2001] WTLR 291.
49 *Fry v Fry* (1859) 27 Beav 144, *Fales v Canadian Permanent Trust Co* (1976) 70 DLR (3rd) 257, 275.
50 *Target Holdings Ltd v Redferns* [1996] 1 AC 421 (HL) 434–5
51 *Breadner v Granville-Grossman* [2000] 4 All ER 705.

trust capital and income to the default beneficiaries, T is estopped from denying that T is personally liable to render an account to O for half the capital (and income subsequently arising therefrom) that T put himself under a duty to transfer to O, Equity looking on as done that which ought to have been done as between T and O before T's neglect put it out of T's power to do what he ought to have done.

While the fundamental incident of trusteeship of property is accountability to the beneficiaries, Equity has extended the categories of accounting parties not just to provide wide-ranging protection for a person in a particular close relationship to another against that other, but to provide protection against third parties whose intervention has had adverse effects. Hence a third party, who dishonestly instigated or assisted a branch of trust or other fiduciary duty, was made personally liable to account as if a trustee in respect of the claimant beneficiary of a trust or other fiduciary relationship,[52] while a third party who received beneficially trust or other property subject to a fiduciary relationship and then dishonestly or unconscionably disposed of it in a fashion inconsistent with the trust or other fiduciary relationship, was similarly personally liable to account as a constructive trustee.[53]

Nowadays, should such liability be simply a liability to pay into the trust fund the amount ordered to be paid after taking the account or to pay equitable compensation directly to beneficiaries absolutely entitled to the trust fund or simply be a liability to pay damages? This may depend upon how one views recent developments affecting tracing, dishonest assistance in breaches of fiduciary duty, and personal liability in respect of property received for one's own benefit but subsequently becoming untraceable.

## C TRACING, OVERREACHING, RECEIPT AND ASSISTANCE

These matters are covered in the following chapters: Chapter 1 (Chambers) "Liability for Breach," Chapter 7 (Birks) "Receipt," Chapter 4 (Fox) "Overreaching," Chapter 6 (Mitchell) "Assistance," and Chapter 5 (Smith) "Property Transferred in Breach."

When a settlor creates a trust by transferring assets to a trustee to be held on the trusts and with the powers set out in the trust instrument, it is customary to define the "Trust Fund" as "the property transferred to the Trustee to hold on the terms of this Settlement together with all property from time to time representing the same."[54] The settlor is responsible for conferring upon his specified beneficiaries equitable interests in the Trust Fund over which he has conferred powers upon the Trustee. Normally, the Trustee will act within the scope of his

[52] Ch 6 (Mitchell).
[53] Ch 7 (Birks).
[54] J Kessler *Drafting Trusts and Will Trusts* (5th edn Sweet & Maxwell London 2000) 359, 366. Such intent would seem to be necessarily implied.

powers as trustee but, having as an individual (or as a corporation, normally nowadays) all the powers of an absolute beneficial owner, he may act beyond the scope of his trusteeship powers and transfer a good title to a bona fide purchaser of a legal estate for value without notice.

Where T does what he is authorized to do then the beneficiaries cannot complain, their interests being overreached,[55] viz detached from the asset disposed of and attached to the proceeds of sale and whatever from time to time represents such proceeds, T's accounts clearly revealing what are the assets from time to time comprised within the Trust Fund.

Where T in breach of trust acts beyond the scope of his powers in selling an asset to a bona fide purchaser as above, the beneficiaries cannot complain to the purchaser but they can all choose to authorize T's conduct[56] so that by the overreaching process their interests become attached to the proceeds of the wrongful (but retrospectively deemed rightful) sale and whatever from time to time represents such proceeds,[57] being able to make T produce accounts clearly revealing what assets currently comprise the Trust Fund. The Trustee cannot plead that he was a bad man and take advantage of his own wrong: he is not allowed to deny that he acted properly in acquiring the asset in question as part of the Trust Fund.

Indeed, if he wrongfully mixed £1,000 of trust money with £1,000 of his own in his private current bank account, as has already been seen the beneficiaries should be able successfully to claim that £1,000 spent thereout on the purchase of an asset that has appreciated in value was an authorized investment on their behalf, T not being in a position to deny or disprove this and try to claim all or half the investment.

Is it not then the case that the original act of the settlor in conferring upon B an equitable proprietary interest in the Trust Fund leads to B via the tracing and accounting process being able to vindicate B's proprietary interest in assets owned by T which T cannot deny are part of the Trust Fund? Does *Foskett v McKeown*[58] not support this? T privately took out a life assurance policy on his own life under which he was contractually obliged to make annual premiums. He paid 3 premiums with his own money and then he wrongfully used trust money to pay 2 premiums before dying, so that £1 million pounds death benefit was payable. If T had been authorized to invest trust money in such policy along with his own money, the beneficiaries would have been entitled to £400,000 representing two fifths of the policy proceeds. Because T could not take advantage of his own wrongdoing, he (and the donees under his will)could not deny the beneficiaries' assertion that they authorized his conduct in using their money to purchase a co-owned interest in the life policy, so their interest

[55] Ch 4 (Fox).
[56] *Wright v Morgan* [1926] AC 788 (PC) 799, *Foskett v McKeown* [2001] 1 AC 102 (HL) 130, *Lewin on Trusts* (17th edn Sweet & Maxwell London 2000) para 39–28.
[57] *Att-Gen for Hong Kong v Reid* [1994] 1 AC 324 (PC) 331.
[58] [2001] 1 AC 102 (HL).

in the money had become detached from the money and attached (by overreaching) to a share of the life policy, which had to feature in the trust accounts.

However, what if the policy had been on the life of T's wife, so that on her death T received £1 million pounds, in £400,000 of which the beneficiaries had an equitable proprietary interest? T then purchased a house with £400,000 out of the £1 million in the name of his mistress, M, as a beneficial gift. Five years later they split up, so M sold the house for £500,000 and purchased with the proceeds a £300,000 flat, a £150,000 painting and jewellery worth £50,000.

Once the tracing rules establish that the £400,000 used to purchase M's house was trust property, then M (taking a derivatively defective title from T) becomes an accounting party being required to show what happened to the house as property that had become part of the Trust Fund. As an innocent volunteer, M has no defence to the beneficiaries' claim to the house as part of the Trust Fund. If she still owned the house she would be no better off than T if T had retained ownership and so she would have to restore it to the trust for the beneficiaries who could justifiably say "we want that back in the trust because it is ours in equity." However what is the position concerning the flat, painting and jewellery representing the house proceeds in the account that M would have to provide as a bare trustee of the house in which she had no beneficial interest, although not appreciating this while owner of the house? One can say that once M learns the true position that her house was subject to the equitable ownership of the beneficiaries then, deriving a defective title from T, she, like T, cannot deny the beneficiaries' claim that she should be treated as purchasing the flat, the painting and the jewellery as authorized agent of the beneficiaries, who can justifiably then say "We want those back in the trust because they are ours in equity." Her "non-wrongful interference with their proprietary rights"[59] (so that she cannot be accountable for any depreciation in the value of the innocently purchased flat, painting and jewellery) thus becomes a rightful transposition of such rights under a retrospective overreaching process. The settlor's intention that the original trust assets and the property from time to time representing them are to be part of the trust fund binds all who cannot deny that intention by proving they are bona fide purchasers for value of the legal title without notice of such trust-creating intention or are otherwise protected by statutory provisions.

In one respect, as an innocent volunteer, M is better off than T (or a "wicked" volunteer whose conscience was affected with knowledge of the trust). If M pooled trust money with her own, half and half, then M and the beneficiaries

[59] L Smith "Unjust Enrichment, Property and the Structure of Trusts" (2000) 116 LQR 412, 422. Professor Chambers' less satisfactory alternative explanation for the proprietary remedy following upon the tracing process is for such remedy to prevent the unjust enrichment of M at the beneficiaries' expense, especially when one considers the otherwise vulnerable position of the beneficiaries in the event of M's insolvency: see also A Burrows "Proprietary Restitution: Unmasking Unjust Enrichment" (2001) 117 LQR 412, 425–428 and Birks in this volume, but Lords Browne-Wilkinson and Millett do not regard the trust of the new assets as restitution of unjust enrichment in *Foskett v McKeown* [2001] 1 AC 102 (HL) 108, 127—nor did the Privy Council in *Att-Gen for Hong-Kong v Reid* [1994] 1 AC 324 (PC).

would equally suffer losses or make gains from assets purchased with the pooled money.[60] Exceptionally, a strong case can be made that if £10 of lottery tickets were purchased or £5,000 was paid to M's mother who then acquired family jewellery worth £20,000 in circumstances where M or her mother, as the case may be, would have exclusively used her own money if she had known the purchasing pool of money was tainted with trust money, then M or her mother should exclusively be owner of the lottery ticket winnings or the family jewellery subject only to a lien thereon for £10 or £5,000 of the trust moneys.[61]

Where a volunteer who innocently received trust property for his own benefit subsequently so dealt with it that it became untraceable, the issue that then arises is whether any personal liability arises in the absence of a proprietary liability. It is clear that if the conscience of the volunteer, V, is affected by actual, Nelsonian or "naughty" knowledge of the trust when V deals with the property inconsistently with the beneficiaries' rights under the trust then V, as a wrongdoer, is personally liable to account for the value of the property.[62] Nowadays there is no reason to add the traditional "as constructive trustee" to "liability to account."[63]

What, however, if V is not at fault in dealing with the property but innocently spends £50,000 of trust money on paying off his mortgage and £5,000 of trust money on a round the world air trip, such debts having been incurred *before* innocent receipt of the £55,000? It seems clear that the beneficiaries will have a proprietary subrogation claim enabling them to be secured creditors over the previously mortgaged house for £50,000[64] and a personal subrogation claim enabling them to replace the travel agent and be unsecured creditors for £5,000.[65] On the basis that such countering of the two transactions does not make V any worse off than before (having exchanged one creditor for another in the same amount), no defence of change of position is available.

Where, fortuitously, the £50,000 and the £5,000 are spent to pay obligations incurred *after* receipt of the £55,000, there is no reason why subrogation claims putting the beneficiaries in the shoes of the creditors paid off with the beneficiaries' moneys should not lie against V, who will have the defence of change of position available to protect him[66] eg, if he would not have spent £50,000 on his

[60] *Foskett v McKeown* [2001] 1 AC 102 (HL).

[61] See D Hayton "Equity's Identification Rules" in PBH Birks (ed) *Laundering & Tracing* (OUP Oxford 1995) 11–12 and *Re Tilley* [1967] Ch 1179 (if it had concerned an innocent volunteer, but Mrs Tilley as a trustee mixing trust moneys with her own in her private bank account was incapable of ranking as "innocent").

[62] *Westdeutsche Landesbank v Islington BC* [1996] AC 669 (HL), *Bank of Credit and Commerce International (Overseas) Ltd v Akindele* [2000] 4 All ER 221 (CA). "Naughty" knowledge arises where V suspects something may be wrong but deliberately or recklessly fails to make the inquiries an honest reasonable person would make: see Hayton & Marshall (n 34 above) para 11–111.

[63] *Paragon Finance plc v Thakerar Ltd* [1999] 1 All ER 400 (CA) 414.

[64] *Boscawen v Bajwa* [1996] 1 WLR 328; *McCullough v Marsden* (1919) 45 DLR 345.

[65] *Wenlock v River Dee Co* (1887) 19 QBD 155; *Banque Financière v Parc (Battersea) Ltd* [1998] 1 All ER 737 (HL).

[66] *Wenlock v River Dee Co* (n 65 above); DJ Hayton *Law of Trusts* (3rd edn Butterworths London 1998) 164; *Lipkin Gorman v Karpnale* [1991] 2 AC 458 (HL); *Philip Collins Ltd v Davis* [2000] 3 All ER 208.

daughter's wedding reception but for believing he was legitimately entitled to the £55,000 windfall, (and, perhaps, where it is not he but circumstances that have changed his position eg, if a painting purchased for £5,000 is destroyed by fire or stolen when not insured[67]).

What, however, if no subrogation claims are possible, as where V innocently received a £250,000 painting which it was not economically viable to insure and which he wanted to retain and not sell? Two years later it was destroyed by fire or stolen, and a year thereafter the beneficiaries seek to make him personally liable. As recipient of trust property, V has to account for what has happened to it, so revealing a nil entry in the account, but this cannot be falsified or surcharged since V was under no trusteeship duties in respect of it, innocently believing the painting to be his property beneficially. This is the traditional approach but it is possible that the courts may, as in the administration of estates *Ministry of Health v Simpson*[68] jurisdiction derived from the ecclesiastical courts or as in the common law action for money had and received, seek to prevent unjust enrichment by the imposition of a strict liability subject to the defence of change of position, which ought to develop so as to be broad enough to cover the lost painting.

Indeed, once one accepts the availability of the broad unjust-enrichment-based subrogation claim as established in *Banque Financière v Parc (Battersea) Ltd*,[69] this so undermines, and minimises the scope for, the fault-based personal liability to account [traditionally as a constructive trustee] that one may as well make personal liability depend on strict liability to prevent unjust enrichment, subject to the defences of bona fide purchaser of a legal interest for value without notice and of change of position, but without prejudice to a higher measure of compensation where the defendant dishonestly dealt with the trust property.[70]

Change of position, however, should not just be a defence to an unjust enrichment claim it should also be available where a claimant seeks to rely on the tracing process to vindicate proprietary rights as Lord Millett had indicated in *Boscawen v Bajwa*[71] and as he indicated in the Symposium, despite having had implicit doubts in *Foskett v McKeown*.[72]

[67] Goff & Jones *The Law of Restitution* (5th edn Sweet and Maxwell London 1998) 824–825; *Derby v Scottish Equitable plc v Derby* [2001] 3 All ER 818 (CA).

[68] [1951] AC 251 (HL) but the recipient should be forced to disgorge his unjust enrichment before defaulting fiduciaries have personally to bear the loss as Lord Nicholls points out in Cornish et al (eds) *Restitution: Past, Present & Future* (Hart Oxford 1998) 241.

[69] [1998] 1 All ER 737.

[70] In Ch 6 Dr Mitchell instances a defendant receiving half of a 60 per cent shareholding, such 30 per cent being worth less to the defendant than the loss caused to the claimant losing a majority holding.

[71] [1996] 1 WLR 328, 334.

[72] [2001] 1 AC 102 (HL) 129 "A claim in unjust enrichment is subject to a change of position defence, which usually operates by reducing or extinguishing the element of enrichment. An action like the present is subject to the bona fide purchaser for value defence which operates to clear the defendant's title."

For third parties who are not recipients of trust property for their own benefit but accessories interfering with trust property or other property subject to a fiduciary relationship it is clear that dishonesty is needed if they are to be personally liable to restore the losses they have caused. Dr Mitchell's thorough and lengthy chapter raised many further issues, three of which will be dealt with here.

First, should a defendant who knows or has good grounds for suspecting that he has assisted in some sort of fraudulent behaviour be absolved from liability because he was not aware of the type of fraud or the identity of the victim(s) eg, he thought he was assisting tax evasion or breach of exchange controls or was defrauding Mr Crook not Mr Bigg (so encouraging a defendant to fabricate some story involving a different fraud and a different victim from the claimant)? Despite the views of Rimer J,[73] Mance J,[74] and dicta of the Court of Appeal,[75] it is submitted that the preferable view is that of Millett J in *Agip Africa Ltd v Jackson*[76] (endorsed by Mason CJ of Australia in answering a question at a public lecture delivered at King's College London):

> It is no defence to a man charged with having knowingly assisted in a fraudulent and dishonest scheme to say that he thought it was "only" a case of tax evasion. It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of the victim. A man who consciously assists others by making arrangements which he knows are calculate to conceal what is happening from a third party takes the risk that they are part of a fraud practised on that party.

Second, should liability be restricted to dishonest assistance in relation to specific property subject to a trust or other fiduciary relationship? It seems that in the interest of maintaining the integrity of fiduciary relations such accessory liability should extend to assistance in (or inducement) of breaches of fiduciary duty that do not involve the misapplication of property, it being open on the authorities to develop this broader approach,[77] despite the fact that traditionally[78] the "knowing receipt" and "knowing assistance" heads of personal liability were both related to interference with equitable proprietary rights.

Finally, taking account of the fact that the tracing process now seems available to assist legal beneficial owners where common law remedies are inadequate,[79] should liability for dishonest assistance be imposed on those dishonestly assisting in the misapplication of property of a legal beneficial owner where common law remedies are inadequate? This seems likely.

[73] [1995] The Times 23 October.

[74] *Grupo Torras SA v Al Sabah Brinks Ltd v Abu-Saleh* (No 3) The Times 23 October 1995 QBD 24 June 1999.

[75] Same case on appeal [2001] Lloyd's Rep Bank 36, 59.

[76] [1990] 1 Ch 265, 295.

[77] *Gencor ACP Ltd v Dalby* [2000] 2 BCLC 734, 757; *Brown v Bennett* [1999] 1 BCLC 649 (CA) 657–9 (directors' breaches related to management of company's affairs) and *Goose v Wilson Sandford* (Court of Appeal 14 March 2000). See broad approach in *Aequitas v AEFC* [2001] NSWSC 14.

[78] *Satnam Invesments Ltd v Dunlop Heywood & Co Ltd* [1999] 1 BCLC 385 (CA) 404.

[79] See the views of Lords Steyn and Millett in *Foskett v McKeown* [2001] 1 AC 102 (HL) 113, 128–9.

## D DEFENCES TO BREACH OF TRUST CLAIMS

The following chapters remain to be considered: Chapter 9 (Lowry and Edmunds) "Honest and Reasonable Breach," Chapter 11 (Swadling) "Limitation" and Chapter 12 (Watt) "Laches, Estoppel and Election."

As Lowry and Edmunds reveal in their Chapter, if the law reports are a reliable guide section 61 of the Trustee Act has become of little significance in the last 50 years,[80] *Re Evans*[81] in 1999 serving to remind us that it is there as a last resort for a trustee who acted honestly and reasonably and ought fairly to be excused from all or part of his or her liability, so that it is almost always going to be a lay trustee, rather than a professional trustee, who will benefit. Nowadays, there is much more use of professional trustees, as management of trusts has become increasingly complex, and such trustees have increasingly relied on very broad exculpatory clauses to protect themselves.[82] If not protected by such clauses, then it is worthwhile settling the case (with a confidentiality clause in the agreement) without going to court to invoke the court's assistance under section 61, which requires washing one's dirty linen in public, not a good marketing exercise for the trustee's professional services.

Mr Watt in his Chapter dealing with laches, cause of action estoppel and election emphasises—some might think over-emphasises, particularly in respect of election—the significance of the public interest (eg, in an end to litigation, quiescence of title and even in fiduciary propriety) and the need for many of the reforms put forward by the Law Commission in its Consultation Paper.

It was Mr Swadling's chapter, however, that conclusively proved the need for a new Limitation Act with clear language moving well away from the obscure language historically present in the 1980 Act and which makes the law on limitation, like the old law on mortgages,[83] "one long *suppressio veri* and *suggestio falsi*." To a lawyer steeped in the history of limitation and of equity[84] the provisions have one meaning, while to a lawyer reading the provisions in accordance with standard English language usage, and with trustees including constructive trustees,[85] they have another meaning.

Before the 1888 Trustee Act it appears (1) that no time limit applied to claims to recover trust property or its traceable substitute still owned by the trustee (the claim being in the nature of a Roman *vindicatio*), and (2) that section 26 of Real Property Limitation Act 1833 brought cases of concealed fraud actions that fell

[80] Section 61 was used to provide some protection for a lay trustee in *Marsden v Regan* [1954] 1 WLR 423 and *Re Evans* [1999] 2 All ER 777 and for a professional trustee in *Re Pauling's ST* [1964] Ch 307 but the court refused such protection to a professional trustee in *Re Rosenthal* [1972] 1 WLR 1273 and *Bartlett v Barclays Bank Trust Co* [1980] Ch 515 (CA).

[81] [1999] 2 All ER 777.

[82] Ch 8 (Penner).

[83] J Brunyate (ed) FW Maitland, *Equity* (2nd edn CUP Cambridge 1936) 182.

[84] Appreciative of Equity's "exclusive", "concurrent" and "auxiliary" jurisdictions.

[85] *Jones v Williams* [2000] Ch 1 (CA) which should have been decided the other way if the Court of Appeal had been able to consider *Paragon Finance plc v Thakerar* [1999] 1 All ER 400 (CA).

within the concurrent or auxiliary equitable jurisdiction into line with the inherent position for cases of concealed fraud actions within the exclusive equitable jurisdiction, so that in all three jurisdictional cases time did not now begin to run before the time when the fraud was first known or could with reasonable diligence have been discovered.

In section 8(1) of the 1888 Act the clause "except where the claim is founded upon any fraud or fraudulent breach of trust to which the trustee was party or privy, or is to recover trust property or the proceeds thereof still retained by the trustee or previously received by the trustee and converted to his use" was intended to cover the above exceptional instances. Subject to these two exceptions, in any action against a trustee or any person claiming through him to recover money or other property, the limitation time bar was as if the action had been for money had and received, but time was not to run against a beneficiary till he had an interest in possession.

The 1939 Limitation Act repealed the 1833 Act and the 1888 Act, with the language in section 19 of the 1939 Act reappearing in section 21 of the 1980 Limitation Act:

> (1) No period of limitation prescribed by this Act shall apply to an action by a beneficiary under a trust, being an action–
>
> (a) in respect of any fraud or fraudulent breach of trust to which the trustee was a party or privy; or
>
> (b) to recover from the trustee trust property [or its traceable substitute]
>
> . . .
>
> (3) Subject to the preceding provisions, an action by a beneficiary to recover trust property,[86] or in respect of any breach of trust, not being an action for which a period of limitation is prescribed by this Act, shall not be brought after the expiration of 6 years from the date on which the right of action accrued.

However, to deal with many cases, including those in section 21 (3) (but not in section 21 (1)), where a period of limitation was statutorily prescribed and either

> (a) the action is based upon the fraud of the defendant; or
>
> (b) any fact relevant to the plaintiff's right of action has been deliberately concealed from him by the defendant; or
>
> (c) the action is for relief from the consequences of a mistake;
>
> the period of limitation shall not begin to run until the plaintiff has discovered the fraud, concealment or the mistake (as the case may be) or could with reasonable diligence have discovered it": section 32 of the 1980 Act, the same as for section 26 of the 1939 Act

[86] As Mr Swadling points out in Ch 11 the preceding provision in s 21(1)(b) leaves no scope for s 21(3) to apply to any proprietary action to recover trust property: see now *JJ Harrison (Properties) Ltd v Harrison* [2001] EWCA Civ 1467, 11 Oct 2001.

except for altering the wording of (b) which in 1939 was "(b) the right of action is concealed by the fraud of [the defendant].

The idea seems to have been that deliberately concealed fraudulent breaches of trust fell within section 21(1)(a) (reflecting the position in section 8 of the 1888 Act that took account of section 26 of the 1833 Act), so that under inherent equitable principles concerning laches time would not begin to run till the beneficiary discovered or could with reasonable diligence have discovered the breach. Non-concealed fraudulent breaches then fell to be dealt with by section 21(3), primarily concerned with honest, negligent or non-negligent breaches of trust, so that there was a six year limitation period running from the date of the breach, but this was then subject to the general provision dealing with all sorts of fraud (tortious, contractual or equitable) and cases where facts were deliberately concealed from the plaintiff, so that time does not run till the plaintiff discovered or could with reasonable diligence have discovered the position involving a breach of trust or contract or a tort.

However, it has been understandably easy for the courts to take the view that on its face section 21(1)(a) covers all fraudulent (viz dishonest) breaches of trust so that, as Millett LJ states,[87] "liability for a dishonest breach of trust endures without limitation of time." Thus, a dishonest breach of trust claim will be barred only when the claimant is guilty of laches, the period of time taken into account for the doctrine of laches running only from the time the claimant knew of the breach or could with reasonable diligence have discovered it.

However, one wonders whether it really matters that all fraudulent breaches of trust are so treated rather than having non-deliberately concealed fraudulent cases dealt with by a six year time bar under section 21(3)? Clearly, it will not matter if the courts in their discretion, taking account of the position for common law fraud, are prepared to consider a six year delay from the earlier of actual or constructive knowledge of the breach as sufficing for laches.[88] In any event will not most fraudulent trustees deliberately conceal their fraudulent conduct?

More significant for the extended liability of trustees, particularly honest trustees, are two Court of Appeal decisions[89] in non-trust cases dealing with the construction of section 32 in extending time limits where "any fact relevant to the plaintiff's right of action has been deliberately concealed from him by the defendant," so that time does not begin to run "until the Plaintiff discovered the concealment or could with reasonable diligence have discovered it." By section 32(2) "deliberate commission of a breach of duty in circumstances in which it is unlikely to be discovered for some time amounts to deliberate concealment of the facts involved in that breach of duty."

87 *Armitage v Nurse* [1998] Ch 241(CA) 260

88 *Nelson v Rye* [1996] 1 WLR 1378.

89 *Brocklesby v Armitage & Guest* [2001] 1 All ER 172; *Cave v Robinson Jarvis & Rolf* [2001] EWCA Civ 245, [2001] Lloyd's Rep PN 290.

It has been held that[90] "any intentional act which amounts to a breach of duty amounts to a deliberate commission of a breach of duty" so as to extend time under section 32; so a trustee need not be aware that his act constituted a breach of trust and it may well be that any conduct suffices, whether being acts of omission or acts of commission. Surprisingly, the six year period for honest, negligent or non-negligent breaches of trust will, therefore, often run not from the date of the act but from the date of the claimant's actual or constructive knowledge of it, so that the envisaged exceptional case becomes the norm. It is, however, to be expected that the House of Lords will peg back section 32's alleged modernistic meaning of a defendant's "deliberate commission of *any act amounting to* a breach of duty" to the traditional meaning of a defendant's "deliberate commission of a breach of duty *known to be a breach of duty*," such meaning giving rise to the otherwise unnecessary[91]enactment of section 14A of the Limitation Act 1980, introduced by the Latent Damage Act 1986 to assist the victims of tortfeasors.

Of more long-standing significance for the extended liability of trustees is the view of the Court of Appeal in *Armitage v Nurse*[92] that because section 21(3) states "the right of action shall not be treated as having accrued to any beneficiary entitled to a future interest in the trust property until the interest fell into possession," time does not begin to run against a person who does not have an interest in possession but is only the beneficiary of a discretionary trust or otherwise the object of a power of appointment which may never be exercised in his favour. Thus, trustees of an 80 year discretionary trust for the descendants of S remain liable throughout much of the period because there will often be someone who could have benefited under the trustees' discretionary powers at the time of the relevant breach but who has not yet benefited or has not received a benefit more than six years ago.

However, because the beneficial extent of the rights conferred by the settlor on the beneficiaries and the correlative burdensome obligations on the trustee-owner of the trust fund can be such as determined by the benevolent or not-so-benevolent settlor, so long as not repugnant to the fundamental trust concept nor contrary to public policy,[93] there may be scope for a clause in the trust instrument to deal with the problems revealed in the preceding two paragraphs. Why should the settlor not reduce the extent of the trustee's obligations not just by a clause exempting the trustee from all liability except for dishonest breaches of trust but also by a clause stipulating that no beneficiary (whether or not having an interest in possession) nor any object of a power of appointment[94] can

[90] *Liverpool Roman Catholic Archdiocese Trustees v Goldberg* [2001] 1 All ER 182, 190.

[91] *Gold v Mincoff Science & Gold* [2001] Lloyd's Rep PN 423.

[92] [1998]Ch 241 (CA) 261

[93] *Armitage v Nurse* [1998] Ch 241 (CA) 251.

[94] While a trust must have ascertained or ascertainable beneficiaries who will be able to enforce the trust by enforcing rights to trust accounts and supporting information as a preliminary to falsifying and surcharging the accounts, it is a question of construction as to whether the settlor has conferred

bring any action in respect of a breach of trust (so as also to protect third parties dealing with the trustee) once six years have elapsed from the date of the breach or, in the case where the trustee knowing he had committed a breach of trust, deliberately concealed such breach, once six years have elapsed since discovery of such concealed breach or the time when such concealment could with reasonable diligence have been discovered.

The settlor is here trying directly to oust section 21(3) ("the right of action *shall not* be treated as having accrued to any beneficiary entitled to a future interest in the property until the interest fell into possession") and also section 32 (1) and (2) as interpreted by the Court of Appeal, so that "the period of limitation *shall not* begin to run until the plaintiff has discovered the concealment or could with reasonable diligence have discovered it," where concealment merely involves an intentional commission of an act amounting to a breach of duty, even if not known by the defendant to be a breach of duty, in circumstances where it is unlikely to be discovered for some time.

Because these two statutory rules are mandatory provisions it seems to be against public policy to allow a settlor directly to oust them. However, public policy rules against making interests in property of a bankrupt cease to be available to his creditors on his bankruptcy do not apply where, instead of a conditional interest, the bankrupt owned merely a determinable interest enduring only until bankruptcy.[95]

Why then should the settlor not expressly provide that any interest of any beneficiary in respect of particular property in respect of which a breach of trust has been committed by the trustee shall only endure until six years have elapsed since the relevant breach of trust or in the case where the trustee, knowing he had committed a breach, deliberately concealed such breach, until six years have elapsed since discovery of such concealed breach or the time when such concealment could with reasonable diligence have been discovered? The beneficiary then has no right of action that can be pursued.

Such provision should validly operate which, in practice, will be fine where the relevant property has ceased to be trust property, but where the breach was negligent investment of the whole trust fund or negligent delegation or negligent supervision of a delegate to whom the whole fund had been entrusted for management, the beneficiary will lose all interest in the trust fund, so that one will need to rely on an express power of the settlor or protector (rather than of

on a mere object of a power of appointment similar rights of enforcement, so there is no problem if the settlor makes clear that he does not wish objects to have such rights: *McPhail v Doulton* [1971] AC 424 (HL) 441, *Re Manisty's Settlement* [1974] Ch 17, 25 and *Rosewood Trust Ltd v Schmidt* (2001) 3 ITELR 734 (Isle of Man appellate decision that a mere object of a power in an exceptionally wide discretionary trust—as opposed to the usual family discretionary trust—had no such rights); also D J Hayton "Exploiting the Inherent Flexibility of Trusts" in DJ Hayton (ed) *Modern International Developments in Trust Law* (The Hague Kluwer Law International 1999) 325–326.

[95] *Brandon v Robinson* (1811) 18 Ves 429, hence the validity of protective trusts as reflected in Trustee Act 1925 s 33.

any wrongdoing trustees) to add back as beneficiaries those beneficiaries whose interests in the trust fund had automatically ceased. However, in some circumstances this could confer interests in the trust fund upon them in respect of which the statutory period of limitation had not expired, so enabling them to sue the trustees[96] unless these interests are expressed to expire upon any action for breach of trust being brought in respect of any matters occurring before conferment of such new interests.

A neater alternative solution is to provide that if any beneficiary brings an action in respect of a breach of trust that occurred more than six years previously or in the case where the trustee, knowing he had committed a breach of trust, deliberately concealed such breach, more than six years after discovery of such concealed breach or the time when such concealment could with reasonable diligence have been discovered, then anything recovered in such action shall be held on trust for the trustee held liable for such breach. To prevent the circuity of the beneficiary exercising the right of action against the trustee, who would then be entitled to the fruits of such action, the trustee is entitled to prevent the beneficiary's action being pursued.[97]

[96] Claiming that the trust fund was not as valuable as it should have been if the trustees had properly performed their duties owed to anyone becoming a beneficiary before statute-barring of any action for breach of those duties. Conferment of an interest only in specified assets then comprised in the trust fund would avoid such a claim, as would adding back a beneficiary merely as an object of a power of appointment expressly excluded from having a right to see the trust accounts and enforce the trust, such right being vested exclusively in the default beneficiaries.

[97] *Ingram v IRC* [1997] 4 All ER 395 (CA) 424 (Millett LJ).

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